Cato Handbook *for* Policymakers

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8TH EDITION

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1. Introduction

We have just been through a most unusual election year, and the direction of public policy seems less clear than it usually is after a presidential election. We know that Americans are dissatisfied with the direction of the country and were not happy with the choices presented to them in November. Still, as we noted in the 2009 edition of the *Handbook*, we can take some satisfaction in observing that something normal happened: a party that had given Americans overregulation, slow growth, and endless (if limited) war, led by an unpopular candidate, was defeated. A republic requires that failed parties be turned out of office. The American Founders believed firmly in the principle of rotation in office. They thought that even successful officeholders should go back home to live under the laws they enacted after a short period in office. No doubt, more members of the 114th Congress would have been given that privilege were it not for the vast complex of laws and regulations and subsidies that protect incumbents.

Once again, the Republican Party has unified control of the House, the Senate, and the White House. The last time that happened, during the George W. Bush administration, they delivered massive overspending, the biggest expansion of entitlements in 40 years, centralization of education, a war that has lasted longer than World War II, an imperial presidency, civil liberties abuses, the intrusion of the federal government into social issues and personal freedoms, and a $700 billion bailout of Wall Street and the automobile industry. Voters who believe in limited government had every reason to reject that record.

At the Cato Institute, we stand firmly on the principles of the Declaration of Independence and the Constitution—on the bedrock American values of individual liberty, limited government, free markets, and peace. Throughout our 40 years, we have been willing to criticize officials of both parties when they sought to take the country in another direction. But we have also been pleased to work with administrations of both parties when they seek to expand freedom or limit government. For example, in

recent years, we worked with the Clinton administration on free trade, welfare reform, and a few tentative steps toward Social Security reform; with the Bush administration on tax cuts, the initial response to the 9/11 attacks, health savings accounts, immigration reform, and Social Security accounts; with the Obama administration on government transparency, surveillance reform, immigration, criminal justice, and the Trans-Pacific Partnership. We look forward to opportunities to work with the Trump administration should it move to reverse the worst mistakes of the Obama years or otherwise advance policies that enhance peace, freedom, and prosperity. Of course, our scholars will not hesitate to criticize unwise, imprudent, or dangerous initiatives from any source.

We urge members of both parties to remember a few policy proposals that have recently been more popular than either presidential candidate or either political party:

- balancing the federal budget,
- school choice,
- legalizing marijuana,
- marriage equality,
- repealing the Affordable Care Act,
- a path to citizenship for illegal immigrants, and
- trade agreements.

The next section elaborates on some of the main policy challenges discussed in this volume. Subsequent sections address broad areas of concern. And near the end of this introduction, I outline four major tasks for Congress.

Policy Challenges

This edition of the *Cato Handbook* contains 80 chapters of policy advice on a wide range of issues. Here I'll touch on just a few.

Peace and Security

The historical foreign policy of the United States, going back to the Founders, was expressed by Thomas Jefferson in his first inaugural address: "Peace, commerce, and honest friendship with all nations—entangling alliances with none." In the 20th century, we moved away from that historical noninterventionist stance to a policy of global intervention. For the past 25 years, we have been involved in a seemingly endless war in the Middle East. Wars that began with limited purposes—to block Saddam

Hussein's takeover of Kuwait and to retaliate against al Qaeda and the Taliban in Afghanistan for the 9/11 attacks—have metastasized into a regionwide campaign of regime change and nation building.

During his campaign for president, Donald Trump criticized this "failed policy of nation building and regime change." He promised that in his presidency, "war and aggression will not be [his] first instinct." As president, Trump should work with Congress to undertake a comprehensive review of the foreign policy of the United States, the most secure power in world history, protected by two oceans and friendly neighbors. In an interconnected world, with terrorism and nuclear weapons, military conflicts should be kept limited and regional, not escalated through superpower involvement.

In Chapter 65, Christopher Preble and Trevor Thrall recommend a foreign policy of prudence and restraint. More broadly, in Chapters 9 and 66–77, Cato's defense and foreign policy scholars explore terrorism, regional issues, and a defense budget appropriate for a constitutional republic.

Economic Growth

In a world of global markets and rapid technological progress, we struggle along with annual growth rates far below what we achieved from World War II until the mid-1970s. That trend has only worsened with the very slow growth that followed the Great Recession. We are by any measure a very wealthy country. Our gross domestic product (GDP) has risen every year, with the exception of a slight drop during the recession. But Americans know that our economy is not working as well as it should. Even before the recession, they feared that their children might not live as well as they did. This slow growth matters most to those who are not yet well off.

In Chapter 6, Brink Lindsey examines the growth slowdown. In Chapter 7, he proposes one particular way to raise the growth rate that should appeal across the political spectrum: taking on "`regressive regulation'—regulatory barriers to entry and competition that work to redistribute income and wealth up the socioeconomic scale." Other chapters suggest more reforms that could increase growth, such as stabilizing monetary policy, reducing the burden of taxes and regulations, and reducing federal spending.

Health Care

Health care has been a major issue in American politics for many years. Dissatisfaction with the Affordable Care Act of 2010 may have played a

role in several recent elections. America leads the world in medical innovation. Yet research indicates that much of what Americans spend on medical care, through both government programs and a private sector heavily dominated by government interference, offers no benefit to patients. As research also indicates, this is in large part because American health care is so often unsafe.

The fundamental problem with U.S. health care is that the consumer does not control the money spent in the sector; the system, instead, serves those who do control the money. For 70 years, government has been assuming greater control over consumers' health care dollars, either by giving workers' earnings to employers or by spending that money itself. When consumers lose control of their health care dollars, they lose control of their health care decisions. Consumers cease to be cost-conscious, and prices rise. Government decides what kind of health insurance we get, where we get it, and how doctors will practice medicine—and more patients end up falling through the cracks. The Affordable Care Act didn't do anything to take us off that path.

In Chapter 4 and Chapters 35–39, Michael Cannon proposes reforms that would make health care higher quality, more affordable, and more secure by putting patients in charge of their health care dollars and decisions.

Fiscal Reform

Federal spending increased by more than a trillion dollars during the George W. Bush years, and then by another trillion dollars during the Obama administration. The national debt rose even more sharply, from $5.7 trillion to more than $10.6 trillion under Bush, and it has almost doubled again under the Obama administration. Trends like this are unsustainable, as Jeffrey Miron notes in Chapter 31. Yet elected officials continue to promise more spending on everything from new weaponry to college tuition to infrastructure. Congress and the administration must find a way to rein in this profligacy. Budget-cutting ideas can be found throughout this *Handbook*, most notably in Chapter 32.

The current rates of spending don't yet reflect the acceleration of entitlement spending that is occurring as baby boomers start to retire. Entitlements are already more than 60 percent of the federal budget, and they continue to grow. The unfunded liability of Social Security and Medicare is nearly $80 trillion, an unfathomably large number. Entitlement spending will accelerate as baby boomer retirement picks up in

coming years and America continues to age. Congress needs to think seriously about this problem. Are members prepared to impose the taxes necessary to fund such levels of transfer payments? Do we want that many Americans dependent on a check from the federal government? Eventually, the projected level of entitlements will not be feasible. Now is the time to make changes—rationally, rather than in a panic a few years hence. Chapters 4 and 35–40 discuss health care and Social Security reform.

Trade and Immigration

Americans sense that our economy isn't working right. Too many of them look for some external force to blame, especially imports, outsourcing, and immigration. And in 2016 they found plenty of candidates ready to propose policies to restrict trade and immigration. That's the wrong approach.

If there's any topic that economists agree on, it is that free trade benefits the whole society. Free trade ensures that goods and services are produced at the lowest cost possible, benefiting consumers. It directs investors, entrepreneurs, and employees toward firms at which they can produce the most value and earn the most income. As trade barriers have come down since World War II, more people in more countries have been able to participate in the global economy and move out of poverty.

Immigration is more controversial, but it too has benefited this nation of immigrants. Immigrants move to the places where opportunities are greatest. They come as producers of goods and services for all Americans and as consumers of the things other Americans produce. Both free trade and immigration can cost particular people their jobs and investments, and that is a painful process. But so can technological development. The invention of farm machinery and the automobile destroyed millions of jobs, but it created more and better jobs. That's a continuing process. There is surely no point in the past—1900, 1950, 1975—at which we should have frozen technology and trade in an attempt to prevent future job losses. Nor is today such a point. The solution for suffering communities in the so-called Rust Belt is not the vain hope of bringing back lost jobs; the solution is to reduce tax and regulatory obstacles to business expansion and job creation.

The term "economic nationalism" has cropped up lately. It may sound good to many ears. Why wouldn't we want our nation's economy to succeed? But what does the term mean? *Wall Street Journal* columnist Bret Stephens answered that question recently:

> In its milder form, economic nationalism means state subsidies for national-champion companies, giant infrastructure projects, targeted tariff protec-

> tions for politically favored industries, "Buy American" provisions in government contracting, federal interventions against foreign takeovers of "sensitive" companies. . . .
>
> In France, it has meant bailouts for failing industrial giants like Alstom. In Japan, it has meant 800% tariffs on imported rice, decades of blowout spending on airports, roads and bridges, and chronic hostility to immigration. Russia passed more protectionist measures in 2013 than any other country, according to the *Moscow Times*.
>
> What do these and other countries that practice variants of economic nationalism have in common? France, where the state accounts for 57% of the economy, hasn't seen annual GDP growth top 3% since the turn of the millennium. Japan, which has the world's oldest population along with the highest debt-to-GDP ratio, experienced no fewer than five recessions between 2008 and 2015. Russia's GDP contracted by 40% between 2013 and 2015. Its economy is now half the size of Great Britain's.
>
> Economic nationalism, in other words, means economic ruin—along with all the political favoritism, crony capitalism and inefficiency that Americans usually associate with Solyndra, the Synfuels Corp., or the Port Authority of New York and New Jersey.

That is not a road the United States should go down. Dan Ikenson discusses a smarter trade policy in Chapter 8, and Alex Nowrasteh points the way to immigration reform in Chapter 13.

The Role of Federalism

Defending the life, liberty, and property of Americans is the fundamental responsibility of the federal government. Clearly, that task requires the focus of the president, federal agencies, and Congress. A government that tries to do everything will do nothing well. Congress should read Article I, Section 8, of the Constitution, which lays out the powers granted to the federal government, and resolve to begin shedding tasks that are inappropriate for the federal government. A good place to begin is by shedding responsibilities that more properly belong to the several states.

Recent administrations have moved us away from our heritage as a federal constitutional republic, with a government of limited powers, and toward a centralized, national plebiscitary democracy with an essentially unconstrained national government. Some people on both the left and the right, particularly when they view themselves as dominant in national politics, seem to want the national government to run everything from our health care system to our local schools. But many Americans still appreciate that the Constitution establishes a government of delegated,

enumerated, and thus limited powers; that most political decisions should be made in the states and communities; that liberty and federalism are still the best foundation for freedom, prosperity, and social harmony.

The philosophy of "centralized nationalism," so alien to the American Founding and our heritage, underlies much of contemporary politics. Who, it is asked, can best comprehend the general will? Why, the national government, of course, and especially the one official elected by all the people—the president of the United States. Unlike Congress, he represents the national interest. The voters have chosen the president, we are told, and Congress should carry out his "mandate." If Congress refuses, then the president may increasingly claim the power to rule by decree, through executive orders. Such a theory would replace the constitutional safeguards against majoritarianism with a president virtually unconstrained in his ability to do good—as he sees it—for the people.

Those who claim the mantle of "liberalism" shouldn't be so quick to toss aside federalism and constitutionalism, because divided powers protect minorities against the whims of the majority. We constrain our government because we know that any of us might be the minority in some dispute and also because we know that—when we're in the majority—we might be tempted to abuse our power. We seek to keep governance close to the people, partly because local government is more responsive and, even more important, because that gives individuals the chance to leave, to vote with their feet, and to find communities that better reflect their individual needs and preferences. About 60 years ago, the need to confront the problem of racist laws in some states led to an increase in the exercise of power by the federal government. The lingering effects of that struggle discredited "states' rights" and federalism, and federal power grew beyond its necessary use to guarantee individual rights in the states. With that period behind us, centralizing the government of 320 million people in a distant capital is a tragic reversal of our liberal Founding. We should remember that the states are "laboratories of democracy" and let them make their own decisions about a wide range of policies.

Conservatives rightly charge liberals with overriding federalism to achieve their policy goals. They ask why New York, Mississippi, and Wyoming have to have the same abortion laws, the same environmental regulations, the same special education rules. But in recent years, conservatives, heady with the thrill of national power, have also used that power to impose their own policy preferences. In the name of accountability and choice, the No Child Left Behind Act further centralized education. The

Bush administration used its administrative powers and the federal courts to block state initiatives on medical marijuana and assisted suicide. Liberals began to see the wisdom of federalism and diversity among the states.

State courts and then state electorates led the way to marriage equality. States are now moving toward decriminalization of marijuana. Finding resistance in a Republican Congress to new gun control measures and minimum wage increases, liberals have turned to the states and cities. During the 2016 campaign, Trump often suggested that decisions should be left to the states—for example, on minimum wages, marijuana, and transgender policy. That's the beginning of wisdom on the role of the national government.

Federalism is not just a good idea for the side that is currently in the minority in Washington. It's the basis of the Constitution. The Founders feared concentrations of power. They believed that the best way to protect individual freedom and civil society was to limit and divide power. Thus, it was much better to have decisions made independently by 13—or 50—states, each able to innovate or to copy successful innovations in other states, than to have one decision made for the entire country. As our population grows and the country becomes more complex, and especially as the government amasses more power, the advantages of decentralization and divided power are even greater.

The Costs of Big Government

Rising numbers of Americans tell pollsters that big government is the biggest threat to America and indeed that the federal government poses "an immediate threat to the rights and freedoms of ordinary citizens." A popular desire for less government is always difficult to translate into substantive reform. It seems to be the nature of democracy that those who seek power and privilege from government are more energetic in the political arena than those who seek only to be left alone. Thomas Jefferson wrote, "The natural progress of things is for liberty to yield and government to gain ground." Economists have explained how every government program provides benefits to a few people while diffusing the costs over all taxpayers or consumers. Congress is more likely to hear from those who receive the concentrated benefits than from those who pay the diffused costs.

But we must recognize the real costs of excessive government. One obvious cost of our gargantuan government is reduced economic growth, as previously noted. With less taxation and less regulation, we could be far wealthier. Another cost is the loss of our freedom. We still live in one

of the freest countries in the world, but each new government program takes away just a little of that freedom—the freedom to spend our money as we choose, to go into the businesses we choose, to negotiate with our employers over compensation and benefits.

A related cost of big government, but one not often recognized, is the harm it does to morality and responsibility. Expansive government undermines the moral character that is necessary to civil society. The "bourgeois virtues" of work, thrift, sobriety, prudence, fidelity, self-reliance, and a concern for one's reputation developed and endured because they are necessary in a world where wealth must be produced and people are responsible for their own flourishing. Government can't do much to instill those virtues in people, but it can do much to undermine them. People should be free to make their own decisions and to bear the consequences of those choices. When we take away freedom and responsibility, we get a society characterized not by thrift, sobriety, diligence, self-reliance, and prudence but by profligacy, intemperance, indolence, dependence, and indifference to consequences.

By taking away money, liberty, and responsibility, the growth of government necessarily shrinks civil society—the whole network of relationships among people, from families to businesses to charities and nonprofit associations that are formed on the basis of consent. Communitarians who deplore the decline of community and cooperation should look to big government for an explanation.

The Role of Congress

In our system of government, Congress plays an important role, as many of the chapters of this *Handbook* point out. Too often, we assume that only the Supreme Court has the duty to uphold the law and the Constitution. In fact, every person elected or appointed to office takes an oath to "support and defend the Constitution of the United States." The first duty of every official is to act within the authority of the Constitution and ensure that other officials do so as well. Recent presidents have blithely exceeded the powers granted to them under the Constitution. But thanks to its negligence, Congress bears a significant part of the blame for presidential excesses. To live up to their oath of office, members of Congress should turn their attention to four tasks, which I discuss in the following sections.

Rein in the President's War Powers

In affairs of state, no more momentous decision can be made than the decision to go to war. For that reason, in a democratic republic, that

decision *must* be made by the most broadly representative body: the legislature. That is where our Constitution lodges the power to declare war. Recent administrations have espoused a view of executive war-making authority that is as unconditional and unconstrained as that claimed by any president in American history. In fact, presidents from Lyndon Johnson and Richard Nixon through George H. W. Bush and Bill Clinton asserted their authority to put American troops in harm's way without the consent of Congress. The Authorization for the Use of Military Force passed by Congress after the 9/11 attacks delegated sweeping powers to President George W. Bush, and President Barack Obama relied on that aging resolution for authority to engage in military actions far beyond what was envisioned in 2001. To ensure that we remain a constitutional republic, not a presidential empire, Congress must reclaim its power under the Constitution to make such momentous decisions and its obligation to debate and vote on war measures. As Gene Healy notes in Chapter 27, Sen. Tim Kaine (D-VA) and Sen. Jeff Flake (R-AZ) have introduced legislation to begin that process.

Stop the Abuse of Executive Orders

Lawmaking by the president, through executive orders, is a clear usurpation of both the legislative powers granted to Congress and the powers reserved to the states. The president's principal duty under the Constitution is to "take care that the laws be faithfully executed"—not to make laws, as presidents increasingly have done. Clinton aide, Paul Begala, boasted, "Stroke of the pen, law of the land. Kind of cool." President Obama declared, "We're not just going to be waiting for legislation. . . . I've got a pen, and I've got a phone." Thus have presidents openly dismissed the legislative process. Both President George W. Bush and President Obama used executive orders to grant themselves extraordinary powers to deal with terrorism. No matter what agenda the president seeks to impose by executive order, Congress should stop him. The body to which the Constitution delegates "all legislative powers herein granted" must assert its authority.

Stop Delegating Lawmaking Authority to the Federal Bureaucracy

Executive orders, however, are only part of the problem. The Constitution clearly grants Congress the power to make laws and grants the executive branch the power to execute the laws. That separation of powers is a key element of the constitutional design. The Founders feared nothing

more than the concentration of powers in one set of hands. But since the 1930s, Congress has gotten into the habit of passing broad laws and leaving the details to administrative agencies. Congress likes to proclaim noble goals, promise good results, and leave the rest to unelected bureaucrats—who must deal with the inevitable tradeoffs and costs of such goals. Congress cannot constitutionally delegate its lawmaking authority to any other body, nor should it want to do so. Congress should accept its responsibility for making law and cease delegating legislation to the bureaucracy.

Consider the Constitutionality of Every Proposed Law

Ours is a government of delegated, enumerated, and thus limited powers. If a power is not granted to Congress in the Constitution, then Congress lacks the authority to legislate in that area. For too long we have drifted toward the idea that everything from our retirement insurance to our local schools to our marriage law is a proper subject for federal legislation. Members of Congress must not leave it to the Supreme Court to decide whether laws are constitutional. Every member must live up to his or her oath of office by considering the constitutionality of every proposed law. Before voting for any bill, each member should ask, "Where in the Constitution is the authority to pass this law?" If the authority cannot be found, members should not vote for the bill. If Congress accepts its responsibility in this way, it will begin the renaissance of constitutional government in the United States.

Of course, the administration can play a role, too. It can stop issuing executive orders, regulations, and agency guidance that usurp Congress's legislative function. It can rescind or withdraw lawless and imprudent rules on topics ranging from school locker rooms to unpaid internships to fracking to presidential authority to kill American citizens without judicial review.

Conclusion

Fidelity to our founding principles of respect for civil liberties and limited government may be easy when times are easy. The true test of our faith in those principles comes when we are beset by diabolical assaults from without and economic turmoil within, when public anxiety may temporarily make it seem expedient to put those principles aside. The importance of paying scrupulous deference to the Constitution's limits

on federal power, of respecting its careful system of checks and balances, is greatest precisely when the temptation to flout them is strongest.

For those who go into government to improve the lives of their fellow citizens, the hardest lesson to accept may be that Congress should often do nothing about a problem—such as education, crime, or the cost of prescription drugs. Critics will object, "Do you want the government to just stand there and do nothing while this problem continues?" Sometimes that is exactly what Congress should do. Remember the ancient wisdom imparted to physicians: first, do no harm. And have confidence that free people, left to their own devices, will address issues of concern to them more effectively outside a political environment.

Suggested Readings

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—Prepared by David Boaz

2. Limited Government and the Rule of Law

Congress should

- live up to its constitutional obligations and cease the practice of delegating legislative powers to administrative agencies—legislation should be passed by Congress, not by unelected administration officials;
- before voting on any proposed act, ask whether that exercise of power is authorized by the Constitution, which enumerates the powers of Congress; and
- exercise its constitutional authority to approve only those appointees to federal judgeships who will take seriously the constitutional limitations on the powers of both the states and the federal government.

Limited government is one of the greatest accomplishments of humanity. It is imperfectly enjoyed by only a portion of the human race; and where it *is* enjoyed, its tenure is ever precarious. The experience of the past century has made clear the insecurity of constitutional government and the need for courage in achieving it and vigilance in maintaining it.

Advocates of limited government are not anti-government, per se, as some people charge. Rather, they are hostile to concentrations of coercive power and to the arbitrary use of power against right. With a deep appreciation for the lessons of history and the dangers of unconstrained government, they advocate for constitutionally limited government, with the delegated authority and means to protect our rights, but not so powerful as to destroy or negate them.

The American system was established to provide limited government. The independent existence of the United States was based on certain truths:

> that all Men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are Life, Liberty, and

> the Pursuit of Happiness—That to secure these Rights, Governments are instituted among Men, deriving their just Powers from the Consent of the Governed, that whenever any Form of Government becomes destructive of these Ends, it is the Right of the People to alter or to abolish it, and to institute new Government, laying its Foundation on such Principles, and organizing its Powers in such Form, as to them shall seem most likely to effect their Safety and Happiness.

On that foundation, the American Founders established a system of government based on delegated, enumerated, and thus limited powers.

The American Founders did not pluck those truths out of thin air, nor did they simply invent the principles of American government. They drew on their knowledge of thousands of years of human history, during which many peoples struggled for liberty and limited government. There were both defeats and victories along the way. The results were distilled in the founding documents of the American experiment in limited government: the Declaration of Independence, the Articles of Confederation, the state constitutions, and the Constitution of the United States.

The American Founders were careful students of history. Thomas Jefferson, in his influential *A Summary View of the Rights of British America*, prepared in 1774, noted that "history has informed us that bodies of men as well as individuals are susceptible of the spirit of tyranny." Patrick Henry summed up the importance of history thus: "I have but one lamp by which my feet are guided, and that is the lamp of experience. I know of no way of judging the future but by the past." History—the lamp of experience—is indispensable to understanding and defending the liberty of the individual under constitutionally limited, representative government.

Through the study of history, the Founders learned about the division of power among judicial, legislative, and executive branches; about federalism; about checks and balances among divided powers; about redress and representation; and about the right of resistance, made effective by the legal right to bear arms, an ancient right of free persons. Liberty and limited government were not invented in 1776; they were reaffirmed and strengthened. The American Revolution set the stage for extending the benefits of liberty and limited government to all. As John Figgis, professor of modern history at Cambridge University, noted at the beginning of the 20th century:

> The sonorous phrases of the Declaration of Independence . . . are not an original discovery, they are the heirs of all the ages, the depository of the emotions and the thoughts of seventy generations of culture.

The roots of limited government stretch far back, to the establishment of the principle of the higher law by the ancient Hebrews and by the Greek philosophers. The story of the golden calf in the Book of Exodus and the investigations of nature by Aristotle both established—in very different ways—the principle of the higher law. Law is not merely an expression of will or power; it is based on transcendent principles. The legislator is as bound by law as is the subject or citizen; no one is above the law.

Many strands have been entwined to form the fabric of liberty:

- **The struggle between church and state**, which was put into high gear in the Latin West by Pope Gregory VII in the 11th century under the motto, "freedom of the church." That movement provided the foundation for such important institutions as the rule of law and legal accountability, federalism, and the independent and self-governing associations that make up civil society.
- **The growth of civil society** in the self-governing chartered towns of Europe, in which the guiding principle was "city air makes one free." The independent cities of Europe were the seedbeds of modern civil society—of the market economy, of personal liberty, and of the security of person and property.
- **The fixing of limits on the powers** of monarchs and executives through written constitutions. To inheritors of the Anglo-Saxon political tradition, the Magna Carta of 1215 and its iterations are the most memorable of those documents. The Magna Carta included the requirement that taxes not be imposed without the consent of the "general council of the realm." That concept laid the groundwork for the English parliament, as well as other very specific limitations on the king's power, including the stipulations that no one be imprisoned or outlawed or exiled or his estate seized "except by the lawful judgment of his peers or the law of the land" and that "merchants shall have safe conduct in and out of England." That language was the precursor of the Petition of Right of 1628, the Bill of Rights of 1689, the American Declaration of Independence, and the American Constitution and Bill of Rights.

Those various movements reinforced each other in a multitude of ways. The assertion of the freedom of the church and even of its supremacy over the secular powers was bound up with the idea of the higher law, by which all are judged—emperor, pope, and peasant alike. As legal scholar

Henry Bracton, a judge during the reign of Henry III, noted of the royal authority, "The law makes him king. Let the king therefore give to the law what the law gives to him, dominion and power; for there is no king where will, and not law, bears rule." Were the king to consider himself above the law, it was the job of the king's council—the precursor of parliament—to rein him in: "if the king were without a bridle, that is, the law, they ought to put a bridle upon him." Not only was the nascent parliament above the king, the law was above the parliament. As Sir Edward Coke noted in the 17th century, "when an act of Parliament is against common right and reason, or repugnant, or impossible to be performed, the common law will controul it, and adjudge such Act to be void."

The supremacy of the law over the exercise of power is a hallmark of the Western legal tradition. The rule of law is not satisfied by merely formal or ceremonial exercises, such as the publication of edicts in barely understandable form, whether in the archaic "Law French" of the king's courts or the pages of the *Federal Register*. The laws must be understandable and actually capable of being followed.

Recognition of the principle of reciprocity between the holders of power and the general populace was also widespread. Rights were enumerated in constitutions and charters. Those rights were not gifts from the powerful, which could be taken away on a whim, but something on which one could take a stand. Tied up in the notion of a chartered right was the ancillary power to defend that right, even to the point of resistance with force of arms. The higher law, reciprocity and mutuality of obligations, written charters of rights, the right to be consulted on policy and to grant or refuse one's consent, and the right of resistance in defense of those rights are the foundations of constitutionally limited government. They were won over many centuries at great sacrifice.

Just how precious that heritage is can be gleaned from comparing it with the history of Russia, where throughout its history there has been very little reciprocity between rulers and ruled and no independent power able to challenge the rulers. The principality of Muscovy and its successors were highly despotic, with no charters of liberty, no power higher than the tsar (or his successors, the Communist Party leaders and now Vladimir Putin), no limits on power—in effect, no law. As Harvard University historian Richard Pipes noted in his book *Russia under the Old Regime*, "There is no evidence in medieval Russia of mutual obligations binding prince and his servitor, and, therefore, also nothing resembling legal and

moral `rights' of subjects, and little need for law and courts." The country's immense difficulties in establishing the rule of law, a system of well-defined and legally secure property, and a market economy are testimony to the great and vital importance of building on a tradition of stable, constitutionally limited government. They also remind us how important it is for us to maintain our heritage of limited government and the rule of law.

The struggle for limited government was a struggle of liberty against power. The demands for religious liberty and the protection of property were fused in the heroic resistance of the Netherlands to the Empire of Spain in their great revolt. The Dutch inspired the English to rise up against the Stuart kings, who sought to fasten upon the English the absolutism that had made such headway on the Continent. The American Revolution was one link in a long chain of revolutions for liberty. The historian John Lothrop Motley opened his magisterial history, *The Rise of the Dutch Republic*, by connecting the Dutch Republic with the United States of America:

> The rise of the Dutch Republic must ever be regarded as one of the leading events of modern times. . . . The maintenance of the right by the little provinces of Holland and Zeeland in the sixteenth, by Holland and England united in the seventeenth, and by the United States of America in the eighteenth centuries, forms but a single chapter in the great volume of human fate; for the so-called revolutions of Holland, England, and America, are all links of one chain.

Motley continued,

> For America the spectacle is one of still deeper import. The Dutch Republic originated in the opposition of the rational elements of human nature to sacerdotal dogmatism and persecution—in the courageous resistance of historical and chartered liberty to foreign despotism.

The Dutch, like the British and the Americans after them, became a shining example of what was possible when people were free: prosperity was possible without the guiding hand of the king and his bureaucrats; social harmony was possible without enforced religious conformity; and law and government were possible without an unlimited and absolute sovereign.

The story of the attempts to institute absolutism in the Netherlands and in England was well known by the American Founders, who were, after all, British colonists. One cannot understand the American attempt

to institute limited, representative government without understanding the history of England. What they were struggling against was the principle that the powers of the state are "plenary," that they fill up the whole space of power. In 1598, King James I of England (then King James VI of Scotland) wrote that "the King is above the law, as both the author and giver of strength thereto." In 1610, James made *A Speech to the Lords and Commons of the Parliament at White-Hall* in which he railed against the notions of popular consent and the rule of law and stated that "as to dispute what God may do is blasphemy . . . so it is sedition in subjects to dispute what a king may do in the height of his power."

In other words, there are no limits to power. Distinct echoes of that view are still heard today. For example, in 1995 under President Bill Clinton, the solicitor general of the United States, Drew Days, argued the case of *United States v. Lopez* before the Supreme Court; he was unable to identify a single act of Congress, other than those expressly prohibited by the Constitution, that would be impermissible under the administration's expansive view of the commerce clause. Days contended that the powers of Congress are plenary, that is, unlimited, unless, perhaps, specifically prohibited. That all-too-common view turns the notion of limited government on its head. Limited government means that government is limited both in the exercise of its delegated powers and in the means it can employ, which must be both "necessary and proper." The English Revolution of 1640, the Glorious Revolution of 1688, and the American Revolution of 1776 were fought precisely to combat unlimited government. What Americans need is not unlimited government, as Days proposed, but limited government under law, exercising delegated and enumerated powers. That is how the equal liberties of citizens are protected. As the philosopher John Locke, himself an active participant in the struggles for limited government in Britain and the primary inspiration of the American revolutionaries, argued in his *Second Treatise on Government*:

> *The end of Law* is not to abolish or restrain, but *to preserve and enlarge Freedom*: For in all the states of created beings capable of Laws, where *there is no Law, there is no Freedom*. For *Liberty* is to be free from restraint and violence from others, which cannot be, where there is no Law: But Freedom is not, as we are told, *A Liberty for every Man to do what he lists*: (For who could be free, when every other Man's Humour might domineer over him?) But a *Liberty* to dispose, and order, as he lists, his Person, Actions, Possessions, and his whole Property, within the Allowance of those Laws under which he is; and therein not to be subject to the arbitrary Will of another, but freely follow his own.

The American experiment in limited government generated a degree of liberty and prosperity that was virtually unimaginable only a few centuries before. That experiment revealed flaws, of course, none of which was more striking and repugnant than the toleration of slavery, or "manstealing," as it was called by its libertarian opponents, for it deprived an individual of his property in his own person. That particular evil was eliminated by the Thirteenth Amendment to the Constitution, showing the self-correcting nature and basic resilience of the American constitutional system, which could survive such a cataclysm as the Civil War.

Other flaws, however, have been revealed or have surfaced since. Among them are the following:

- **An erosion of the basic principles of federalism**, as the federal government has consistently encroached on the authority of the states. Federal criminalization of acts that are already criminalized by the states, for example, usurps state authority (as well as circumventing—opinions of the Supreme Court notwithstanding—the prohibition against double jeopardy in the Fifth Amendment to the Constitution: "nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb"). An even more striking contemporary example of the overreach of federal law is the continued exercise of federal controls over marijuana use in states that have legalized the medical or recreational use of that drug. The Tenth Amendment is quite explicit on this point: "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."
- **Violation of the separation of powers** between the various branches of government. In Article I, Section 8, for example, the Constitution explicitly reserves the power to declare war to Congress, a power that Congress has allowed to be usurped by the executive branch and which it should retake to itself. (See Chapter 27.)
- **Failure of the legislative branch to fulfill its responsibilities** when it delegates its legislative powers to administrative agencies of the executive branch, such as the Department of Labor, the Federal Trade Commission, and the Consumer Financial Protection Bureau. In addition to violating the Constitution, that failure has led to the erosion of the rule of law, as administrative agencies have burdened us with an unimaginably complex welter of edicts. The *Federal Register* ran 97,000 pages in 2016, reflecting a degree of minute regulation that is unreasonable and burdensome. It virtually guarantees that any

citizen involved in a commercial transaction, for example, will run afoul of some part of it, no matter how well intentioned or scrupulous he or she may be. This situation is an invitation to the arbitrary exercise of power, rather than the application of law. Such extensive delegation of powers is an abdication of the representative function described in the *Federalist Papers* and elsewhere by the Founders. Members of Congress are thereby converted from representatives of their constituents into "fixers," who offer to intercede on behalf of constituents with the agencies that are illegally exercising the authority of the legislative branch. Thus, members of Congress can avoid responsibility for onerous laws but can take credit for gaining special treatment for their constituents. That system may be thoroughly congenial to the interests of the existing officeholders of both the executive and the legislative branches, but it is directly contrary to the doctrine of the separation of powers and to the very concept of representative government. (See Chapter 3.)

- **Inattention to the important role of the federal judiciary** as a check on arbitrary and unauthorized exercises of power. Especially since the Court-packing "constitutional revolution of 1937," the federal judiciary—and Congress, in ratifying judicial nominees—have focused too little attention on fulfilling the role of the courts in enforcing constitutional restraints on both the federal and the state governments, as set out in Article III, Section 2, of the Constitution. Sections of the Constitution that have suffered from relative neglect include Article I, Section 1 ("All legislative Powers herein granted shall be vested in a Congress of the United States"); Article I, Section 8 (enumerating and thus limiting the powers of Congress); Article I, Section 10 ("No state shall . . . pass any . . . Law impairing the Obligation of Contracts"); the Fifth Amendment ("No person shall be . . . deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use without just compensation"); the Ninth Amendment ("The enumeration in the Constitution of certain rights shall not be construed to deny or disparage others retained by the people"); the Tenth Amendment ("The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people"); and the Fourteenth Amendment ("No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States"). Although the First and Four-

> teenth Amendments have indeed been the source of significant judicial activity, the Court has not consistently applied the prohibitions of the First Amendment to either commercial speech or political speech (the latter in the context of campaign finance). Nor has the Court rectified the novel (and specious) distinction between personal liberties and economic liberties drawn by Justice Harlan F. Stone in *United States v. Carolene Products Co.* (See Chapter 15.)

Those flaws can, however, be corrected. What is needed is the courage to place the health of the constitutional order and the future of the American system above short-term political gain. The original American Founders were willing "to mutually pledge to each other our Lives, our Fortunes, and our sacred Honor." Nothing even remotely approaching that would be necessary for today's members of Congress to renew and restore the American system of constitutionally limited government.

In defending the separation of powers established by the Constitution, James Madison clearly tied the arrangement to the goal of limiting government power:

> It may be a reflection on human nature that such devices should be necessary to control the abuses of government. But what is government itself but the greatest of all reflections on human nature? If men were angels, no government would be necessary. If angels were to govern men, neither external nor internal controls would be necessary. In framing a government which is to be administered by men over men, the great difficulty lies in this: you must first enable the government to control the governed; and in the next instance oblige it to control itself. A dependence on the people is, no doubt, the primary control on the government; but experience has taught mankind the necessity of auxiliary precautions.

For limited government to survive, we need a renewal of both of the forces described by Madison as controls on government: dependence on the people, in the form of an informed citizenry jealous of its rights and ever vigilant against unconstitutional or otherwise unwarranted exercises of power, and officeholders who take seriously their oaths of office and accept the responsibilities they entail.

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—Prepared by Tom G. Palmer

Bipartisan Action Agenda

3. Toward a Congressional Resurgence

Congress should

- reclaim the power to make law by requiring an up-or-down vote on all "major rules" involving more than $100 million in economic costs;
- establish a standing committee to review past legislation and identify broad statutory language that abets executive overreach in rulemaking;
- revise the Administrative Procedures Act to make clear that federal courts reviewing agency action are to decide questions of federal law de novo, without deference to agencies' interpretations of their own authority; and
- reclaim the power of the purse by enacting a law requiring that all profits, fees, fines, civil and criminal forfeitures, and other revenues be deposited in the Treasury and spent through the normal congressional appropriations process.

"In absolute governments, the king is the law," Thomas Paine proclaimed in *Common Sense*, but "in America, the law is king." We've come a long way since 1776: increasingly, in 21st century America, the *president* is the law. Over the last decade and a half, the "most powerful office in the world" has grown more powerful still, thanks to two presidents in a row who repeatedly pushed the limits of executive authority and a succession of Congresses unwilling to push back.

President George W. Bush earned his reputation as the imperious "decider" thanks to his sweeping claims of inherent executive power in foreign affairs. Yet by the end of his second term, Bush had also radically expanded presidential power on the home front, into areas where no plausible national security claim could be made. In December 2008,

Bush unilaterally ordered a multibillion-dollar auto bailout just days after Congress voted the program down. A White House spokesman explained that "Congress lost its opportunity to be a partner because they couldn't get their job done."

"The biggest problems we're facing right now," Sen. Barack Obama intoned on the campaign trail in 2008, involve the "president trying to bring more power into the executive branch and not go through Congress at all." By 2011, President Obama had decided that "we can't wait" for Congress to pass laws before the president acts. "We're not just going to be waiting for legislation in order to make sure that we're providing Americans the kind of help they need," he warned. "I've got a pen, and I've got a phone." And he proceeded to use them to

- unilaterally grant lawful status and eligibility for federal benefits for nearly half of the 11 million unauthorized immigrants in the country;
- force schools throughout the country to adopt national curriculum requirements or suffer federal penalties;
- issue regulatory "guidance" documents purporting to make the rules for nearly every school and workplace bathroom in the United States;
- promulgate new rules that nearly quadruple the number of workers eligible for overtime pay;
- force American power plants and, ultimately, electricity consumers to bear billions of dollars of costs to reduce greenhouse gas emissions, though Congress has never voted to treat CO_2 as a pollutant; and
- unilaterally amend the Affordable Care Act (ACA) by ignoring clear statutory deadlines and mandates passed by Congress.

During his efforts to revise the ACA unilaterally, President Obama even usurped the "power of the purse," ordering the disbursement of some $7 billion in "cost-sharing" subsidies that Congress never appropriated. At a congressional hearing in July 2016, Obama administration officials could not identify any legal authority for those expenditures. Still, Treasury official Mark J. Mazur volunteered, "If Congress doesn't want the money appropriated, they could pass a law that specifically says don't appropriate the money from that account."

Our system of separated powers was designed to force deliberation and consensus; for a bill to become law, it needs to meet with the approval of the representatives of three different constituencies: the House, the Senate, and the president. But when the executive branch makes "law" unilaterally, those procedural hurdles stand in the way of undoing what

he has ordered with the stroke of a pen. As Justice Anthony Kennedy remarked during oral argument in *U.S. v. Texas*, the challenge to the president's sweeping immigration directives, "that's just upside down."

Even as he forged new frontiers in unilateral power, President Obama reportedly worried about "leaving a loaded weapon lying around" for future presidents to wield. That weapon now belongs to Donald J. Trump, our 45th president, who has promised to "do a lot of right things" with executive orders, and whose governing philosophy, as expressed in his acceptance speech at the Republican National Convention, is "I alone can fix it."

That's the political environment facing the 115th Congress, and, like the prospect of a hanging, it ought to concentrate the mind wonderfully. As we'll see, Congress bears much of the blame for the rise of one-person rule, having abdicated its core constitutional responsibility for making the law. But the crisis of executive governance creates an opportunity for a congressional resurgence. This chapter offers a number of reforms that, if implemented, would go some distance toward revitalizing Congress.

Congress and the Presidency in the Constitutional Order

The current regime of executive-branch dominance is at odds with our Constitution's structure and history. Presidential hegemony wasn't part of the original plan: the Framers never conceived of the president as America's "national leader" and the prime mover in the federal system. Neither did they subscribe to the Jacksonian notion that the president, as the only nationally elected figure, was the "direct representative of the American people" or, as Theodore Roosevelt saw it, uniquely the "steward of the whole people," with special powers to act on their behalf.

If anything, Congress had the superior democratic pedigree. Compared with the chief executive or the federal judiciary, the members of the legislative branch, who "dwell among the people at large," Madison wrote in *Federalist* No. 49, were "more immediately the confidential guardians of the rights and liberties of the people." And it is Congress that, on parchment at least, has the superior powers. Just as the Capitol dome looms over the president's house in the architecture of the federal city, Congress overshadows the president in the structure of the federal Constitution.

"All legislative Powers herein granted shall be vested in a Congress of the United States," the document proclaims in Article I, Section 1, the first sentence following the Preamble. Congress wields the power of the

purse; it establishes the structure of the executive branch, and the rules under which it operates. It can create or abolish agencies, remove department heads and even, through the impeachment power, remove the president. The president has no reciprocal powers allowing executive control over Congress.

The first sentence of Article II vests "The executive Power" in the president. At its core, that power consists of the authority to carry into execution the laws that Congress makes. The point is underscored in Article II, Section 3, which imposes a number of duties on the president, among them that he "shall take Care that the Laws be faithfully executed."

The Constitution was not a blueprint for a government of co-equal branches. To the contrary, as Madison explained, "in a republican government, the legislative authority necessarily predominates." In fact, given the relative balance of the branches' formal powers, the Framers worried about Congress overwhelming the president. Experience in the states, where "the legislative department is everywhere extending the sphere of its activity, and drawing all power into its *impetuous vortex*," served as a cautionary tale. To guard against that danger, the Constitution's architects divided the legislature into separate branches and fortified the president with the veto, as a defensive weapon.

The Presidency Transformed

From our vantage point, the Framers' concerns about legislative dominance seem almost quaint. By the mid-20th century, the *executive's* "impetuous vortex" threatened to swallow up the powers of the "first branch."

In the first century of the Republic, when Congress still served as the country's principal lawmaker, presidents issued fewer than 800 executive orders in total. Yet as the chief executive's responsibilities expanded, so too did his power to govern by decree. From Truman through Nixon, presidents issued over 2,200 executive orders, which became increasingly indistinguishable from legislative acts. For its part, Congress facilitated the growth of presidential rule by drafting increasingly broad and vague laws that accorded the executive discretion in interpretation and implementation. Legal scholar Gary Lawson has likened the legal regime that emerged from unrestrained delegation to one governed by "a statute creating the Goodness and Niceness Commission and giving it power `to promulgate rules for the promotion of goodness and niceness in all areas within the power of Congress under the Constitution.'" The myriad "goodness and niceness" commissions of the modern administrative state go by different

names and have narrower purviews individually, but collectively, they're hard to distinguish from Lawson's reductio ad absurdum.

In the latter part of the 20th century—not coincidentally a period characterized by the "emerging Republican majority" in the Electoral College—conservatives perceived advantages to presidential dominance. Using the enhanced powers of the presidency, conservative chief executives could gain control over the administrative state and rein in the regulators, they reasoned. But as Elena Kagan—formerly a policy adviser in the Clinton administration and now a Supreme Court Justice—pointed out in a 2001 *Harvard Law Review* article, there's little reason to think that "presidential supervision of administration inherently cuts in a deregulatory direction." A liberal president could use his control over the administrative state to pursue "a distinctly activist and pro-regulatory agenda"—as President Bill Clinton had done and President Obama later would do.

Federal Courts to the Rescue?

President Obama's aggressive use of executive power spurred a legislative response in the House. Yet congressional efforts thus far have fallen far short of what's needed to restore the first branch's constitutional powers. Too often, those efforts have been half-hearted measures aimed at getting the federal judiciary to save the legislative branch from its own fecklessness. Indeed, when asked in a June interview how he'd handle a President Trump's attempts to govern without Congress, House Speaker Paul Ryan (R-WI) replied, "I would sue any president that exceeds his or her powers."

That's the strategy behind the ENFORCE the Law Act ("Executive Needs to Faithfully Observe and Respect Congressional Enactments"), which passed the House in 2014. The bill is designed to make it easier for Congress to take the president to court when legislative majorities determine that he has violated the Take Care clause—instead of punishing the violation themselves.

To be sure, the judiciary has an important role to play, as made clear by two recent court victories in challenges to Obama administration unilateralism. In *U.S. v. Texas*, the Fifth Circuit upheld (and the Supreme Court later affirmed) a preliminary injunction against President Obama's sweeping immigration directives, noting that federal law "flatly does not permit the reclassification of millions of illegal aliens as lawfully present." And in *House of Representatives v. Burwell,* former House Speaker John Boehner's lawsuit challenging the president's post hoc revisions of the ACA met with partial, provisional success when a D.C. federal judge held

the cost-sharing expenditures unlawful: "Congress is the only source for such an appropriation, and no public money can be spent without one."

Yet the federal courts are unlikely to serve as a deus ex machina that repeatedly rescues Congress from a problem largely of its own making. They've been notably skeptical about past attempts by Congress to bootstrap itself into legislative standing. In *Burwell*, Judge Rosemary Collyer found that the House had standing on the unlawful appropriations claim, but did not with regard to the president's refusal to implement the employer mandate by the ACA deadline. And she stayed her ruling on the first claim, allowing the unauthorized expenditures to stand, pending appeal.

Nor has the judiciary historically shown much appetite for policing the boundaries between executive and legislative power: between 1943 and 1997—a period that saw some 4,000 executive orders—presidents lost only 14 times in federal court challenges to those orders. Congress's predilection for broad, vaguely worded delegations of legislative authority has concentrated enormous discretionary power in the president's hands, and the courts rarely find that he's taken too much of what Congress has freely given. Since 1937, as Justice Stephen Breyer has noted, "the Court has only twice in its history found that a congressional delegation of power violated the `nondelegation' doctrine." In 2001, the Court found that Congress did not violate the Constitution by enacting the Clean Air Act that gave the Environmental Protection Agency legislative power to set air quality standards using criteria that "protected the public health" with "an adequate margin for safety." As federal Judge Douglas Ginsburg remarked, "the statute effectively delegated to an unelected and unaccountable agency the decision how far our society should go and how many billions of dollars should be spent to reduce the adverse health effects of industrial pollution, a decision that seems quintessentially legislative, but undoubtedly one for which legislators would prefer to avoid responsibility."

Ultimately, the "least dangerous branch" is unlikely to revive the nondelegation doctrine or serve as reliable bulwark against overbroad assertions of executive power. Congress will have to reclaim its powers itself.

Thankfully, the powers the Constitution gives to the first branch are more than adequate to that task. As the legal scholar Charles Black noted four decades ago in the wake of Watergate, "My classes think I am trying to be funny when I say that . . . Congress could reduce the president's staff to one secretary . . . [and] put the White House up at auction. . . . [But] these things are literally true."

If Congress has the legal power to sell the White House, it certainly has the power to constrain and discipline the president in less dramatic

fashion: to punish unauthorized spending, police violations of the Take Care clause, and reclaim responsibility for making the laws Americans are required to follow. What's needed now is for Congress to recognize the powers it has and begin flexing muscles grown slack with disuse.

Reclaiming the Power to Make Law

To begin with, if members of Congress are concerned with presidential power grabs, they should stop *enabling* them. Too often, legislators have given the president a colorable claim to legal authority by passing broad and vaguely worded statutes that leave the details to be worked out by the executive branch. Congress should establish a standing committee to review past legislation and identify broad statutory language that abets executive overreach in rulemaking. The new committee would propose new, narrower language for existing statutes to restore congressional control over agencies.

Congress should also consider "framework" legislation that promotes legislative accountability for new regulatory rules going forward. In the Congressional Review Act of 1996, Congress defined a "major rule" as a regulation that involves more than $100 million in costs or otherwise significantly affects the economy. That act provided expedited procedures for members to challenge proposed regulations, via a disapproval resolution, which, if passed by both houses and signed by the president, prevents the rule from going into effect. In its 20 years of existence, the act has been successfully employed to stop a final rule only once.

The proposed Regulations from the Executive in Need of Scrutiny (REINS) Act represents a more promising approach to reclaiming congressional responsibility for lawmaking. It would require Congress to vote "major rules" into law before they take effect. Under its provisions, agency rules that meet the criteria are automatically introduced into each house and fast-tracked toward an up-or-down vote within 70 days. If enacted, the REINS Act, versions of which have passed the House three times since 2013, would increase Congress's workload, forcing members to consider 50–100 major rules per year. But, as the Hudson Institute's Christopher DeMuth has put it, "Should not members of Congress stand and be counted on regulatory policies costing $100 million or more, even if that means spending less time naming post offices after one another and proclaiming National Orange Juice Week?"

Further, Congress should consider revising the Administrative Procedures Act (APA) to empower judicial review of executive agency actions.

Such review has become utterly anemic over the last several decades, under the judicially created *Chevron* doctrine, by which the courts accord executive-branch agencies extraordinary deference to their interpretations of their own statutory authority. A bill introduced in the House and the Senate in 2016 would overturn *Chevron* deference, amending the APA to empower courts to decide "de novo all relevant questions of law, including the interpretation of constitutional and statutory provisions and rules."

Congress could also address agencies' use of "coercive guidance" to expand their authority, meaning guidance issued outside of the normal notice-and-comment procedures dictated by the APA. Congress could amend the APA to establish "qualified immunity" for regulated parties, private or public, who violate abstract or contested rules issued as informal policy statements that outline proscribed behavior. In practice, such regulatory targets would not be held liable retrospectively. Law professor William Baude has described how qualified immunity would change "coercive guidance":

> If presented with executive guidance that takes an aggressive or questionable interpretation of the underlying statute, the regulated entity would now be able to more confidently go on about its business, ignoring the agency's position. It is still equally possible for the agency to impose sanctions and take the regulated entity to court, but the entity has been insured to some degree against the risk of losing a novel question of law. This makes it far more likely that debatable executive interpretations will end up subject to judicial review, and hence far more likely that they will ultimately be subject to congressional constraints.

Reclaiming the Power of the Purse

Congressional shortcomings go beyond delegation of its legislative power. Article I of the Constitution states, "No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law." Nonetheless, a number of regulatory agencies rely on funding extracted outside the normal appropriations process and the congressional oversight it enables. For example, the Federal Communications Commission sets and collects about $8 billion in taxes on landline and wireless telecommunications companies, cable companies that provide voice service, and paging service companies. The commission then has broad discretion in spending that money to achieve "universal service." In this case, the "power of the purse" seems to be migrating to the executive branch. "All of this is easily fixed," notes legal scholar Michael McConnell. Congress can "pass a statute

providing that all profits, fees, fines, civil and criminal forfeitures . . . and other revenues must be deposited in the Treasury and spent only in accordance with congressional appropriations."

Moreover, when it comes to presidential inaction and failure to faithfully execute the laws, the power of the purse is likely to be more effective than the proposed ENFORCE the Law Act. As Justice Antonin Scalia put it in a 2012 case, "Nothing says `enforce the Act' quite like `. . . or you will have money for little else."

Crisis and Opportunity

Reining in the president's de facto law-making powers won't be easy. Members may be tempted to delegate their power to avoid responsibility for policy outcomes. But business as usual will only encourage the growing public perception that the game is rigged. The long decline in respect for Congress occurred during a period when it increasingly abdicated responsibility and power to the executive branch and stems in large part from the popular perception that, as an institution, it has become useless.

Unfortunately, Congress has done much to foster that perception. As Senator Mike Lee (R-UT) recently noted, "at the end of the day, the real change can't come to federal law until it comes to federal lawmakers. Congress has to re-assert its Article 1 powers—and get back in the habit of doing its job."

The crisis in executive governance—heightened by the recent presidential contest between two of the most reviled public figures in modern memory—is an opportunity for congressional "institutionalists." And all the powers the Framers gave Congress are there for institutionalists' taking.

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—Prepared by Gene Healy and John Samples

4. Repealing Obamacare

States should

- refuse to implement the Patient Protection and Affordable Care Act's Medicaid expansion if they have not already implemented it, or withdraw from it;
- conduct randomized, controlled experiments measuring the effects of Medicaid on existing enrollee populations; and
- liberalize government licensing of clinicians, government licensing of health insurance, and medical malpractice liability rules.

Congress should

- conduct oversight hearings at which Americans can testify to the failure of the ACA to provide quality, affordable coverage;
- repeal the ACA, no matter how long that takes;
- replace the current tax exclusion for employer-paid insurance premiums with an exclusion for contributions to "large" health savings accounts (see Chapter 37);
- convert Medicare to a system of cash payments to enrollees (see Chapter 38);
- convert federal funding for Medicaid and the State Children's Health Insurance Program to a system of block grants (see Chapter 39); and
- prevent states from blocking market entry by clinicians and insurers licensed by another state (see Chapters 35 and 36).

Despite the good intentions of its authors, the Patient Protection and Affordable Care Act of 2010 (ACA) is failing the sick. It is making access

to care for the sick increasingly less secure. It is drawing workers and their families out of relatively secure and comprehensive private insurance into government programs. It is blocking innovations that would make access to care more secure. It is making health insurance and medical care increasingly unaffordable. It is not covering as many uninsured Americans as promised. It is making the United States a less wealthy nation, eliminating jobs, increasing the burden of government, and trapping Americans in poverty. The actions its defenders have taken to preserve it have strained comity and the rule of law, leaving the ACA a law with no legitimacy. The ACA has been consistently unpopular with the American people for more than seven years.

Congress should not rest until it has repealed the ACA. A Republican Congress and President Barack Obama have jointly repealed portions of the law. Congress has already approved legislation that would repeal a majority of the ACA and then force Congress to reopen or repeal the rest. Any repeal bill can provide a safety net for those who would not be able to afford health insurance after enactment. Repealing the ACA will create an opportunity for real reform that makes health care better, more affordable, and more secure for all Americans—and thus reduces the need for a safety net, the expense of a safety net, and the controversy surrounding it. Little will improve for consumers under age 65 so long as the ACA's new health insurance regulations, mandates, and subsidies remain on the books.

Insecure Coverage

The ACA has failed to make health insurance secure. Before he signed it into law, President Obama repeatedly assured Americans, "If you like your health care plan, you'll be able to keep your health care plan, period. No one will take it away, no matter what." The president and other supporters knew this was not true. The ACA has thrown millions of Americans out of their health plans for various reasons, none of them good. It will continue to do so until Congress repeals it.

When the ACA took effect in 2014, as many as 12 million Americans lost their individual-market plans and the guaranteed-renewability protection those plans offered. The *Washington Post* reported, "The Department of Health and Human Services estimated in 2010 that up to 80 percent of small-group plans, defined as having fewer than 100 workers, could be discontinued by the end of 2013," affecting up to 100 million workers. The cancellations are ongoing.

The ACA is causing Americans to lose their coverage because the law gave taxpayer dollars to incompetent people. Seventeen of the 23 health insurance "co-ops" that the ACA launched with taxpayer funding went bankrupt by 2017. More than 800,000 Americans lost their coverage when those plans folded. The remaining co-ops are on shaky ground.

The ACA is throwing Americans out of their health plans by literally punishing insurers who offer coverage attractive to the sick. The law replaced market innovations that make comprehensive coverage more secure with a system that punishes insurers unless they make coverage progressively worse for the sick.

Before Congress enacted the ACA, individual-market policies included an innovative feature called guaranteed renewability. This feature allows enrollees who develop expensive conditions to pay the same premiums as healthy people. Research shows that guaranteed renewability made individual-market coverage more secure than employer-sponsored coverage, even for people with high-cost conditions. Guaranteed renewability made stable access to comprehensive coverage possible.

Markets didn't stop there. While Congress was debating the ACA, UnitedHealthcare secured approval from 25 states to sell an innovative and low-cost product that allows *uninsured* people who develop expensive medical conditions to purchase insurance at the same premiums as healthy people.

Innovators developed guaranteed renewability and preexisting-conditions insurance in the individual market because it was the only market without government-imposed price controls. The ACA put an end to the innovations when it imposed community-rating price controls on the individual market.

The result has been a race to the bottom. Many ACA exchange plans are Medicaid-based plans that offer narrow networks of doctors and hospitals and lower premiums. These plans are attractive to the healthy, who care more about low premiums than about broad provider networks. Sicker enrollees are the opposite: they care about comprehensive coverage and a broad choice of providers. Sicker enrollees therefore find these plans unattractive. They instead opt for plans that offer a broader choice of providers and more coverage for specialty drugs.

The ACA rewards Medicaid-based plans like Molina Healthcare and Centene Corp. that offer narrow coverage networks. At the same time, it punishes carriers that offer the sort of health plans sick people actually want. Under the ACA, comprehensive plans end up paying claims well

in excess of premium revenues, which drives those plans from the marketplace. Citing such losses, UnitedHealth Group announced it would go from participating in 34 states to just 3, canceling coverage for most of its 750,000 exchange enrollees. Humana announced it would go from selling exchange coverage in 1,351 counties to 156 counties or fewer in 2017, canceling coverage for most of its 500,000 exchange customers. Blue Cross and Blue Shield of Minnesota is withdrawing from that state's exchange, canceling coverage for 103,000 enrollees.

The ACA offers still more ways for Americans to lose their coverage. It offers coverage that can disappear when their employer changes how much it pays for their benefits; when enrollees turn 19, or 26, or 65; when they become disabled; when they get arrested; when their income falls; when their income *rises*; or when courts or elections put an end to the taxpayer subsidies propping up their plan. Economist Casey Mulligan describes the arcane and unpredictable ways Americans can lose their ACA coverage:

> A family could have calendar year income below the poverty line but for parts of the year have income above its state Medicaid threshold and for that part of the year fail to be eligible for either Medicaid or exchange subsidies. Or it could have calendar year income above the poverty line and above its state's Medicaid threshold but have income during part of the year below the latter and therefore be eligible for Medicaid during part of the year and for exchange subsidies for the rest of the year.

Every time a patient loses her health insurance, including when she switches between Medicaid and exchange coverage, her coverage can be interrupted, threatening her access to her doctors and other providers.

Rather than providing a path to secure, continuous coverage, the ACA creates countless gaps in coverage and punishes insurers who offer coverage attractive to the sick until there isn't any choice at all. The Kaiser Family Foundation estimates 664 counties will have only one exchange carrier in 2017, up from 225 in 2016.

Low Enrollment

The ACA has failed to reach its enrollment goals. Enrollment in the ACA's exchanges is about half what supporters expected. The Congressional Budget Office projected 21 million exchange enrollees in 2016. Instead, there were 11 million. It projected 17 million additional Medicaid enrollees. Instead, there were fewer than 13 million—a product of the

countervailing effects of 19 states refusing to implement the Medicaid expansion, and enrollments (and costs) vastly exceeding projections in the 31 states that have. (See below.)

Exchange coverage is unattractive even to those eligible for subsidies. An estimated 24 million people are eligible for subsidized exchange coverage. Only 40 percent of those eligible have enrolled. Sixty percent of people eligible for subsidies still think ACA coverage isn't worth it. Those who do enroll appear to be the sickest among that group, who then learn the ACA punishes insurers who provide the coverage they want.

Excessive Costs

The ACA has failed to contain the cost of health insurance. Premiums for exchange plans have been climbing at a rate consistent with adverse selection and possibly a death spiral. That comes on top of past increases. Economist Amanda E. Kowalski estimated, "Across all states, from before the reform to the first half of 2014, enrollment-weighted premiums in the individual health insurance market increased by 24.4 percent beyond what they would have had they simply followed state-level seasonally adjusted trends." A study of unweighted premiums found the ACA increased premiums by an average of 49 percent. Premiums for commonly purchased plans rose an average 22 percent in 2017. In Oklahoma, they rose an average 76 percent. Many enrollees saw their premiums double.

ACA supporters respond that many enrollees receive subsidies and therefore do not feel the full effects of those increases. Yet the majority (52 percent) of consumers subject to the ACA's individual-market rules get no subsidies. Even when they do, subsidies do not make the costs of ACA coverage disappear. They merely shift them to taxpayers. The ACA's subsidies create problems for taxpayers, the economy, and the subsidy recipients themselves.

In addition, the Medicaid expansion is costing taxpayers far more than projected. In 2015, the expansion cost $6,366 per enrollee, almost 50 percent higher than the government projected. In some states, the cost of the Medicaid expansion has exceeded projections by billions of dollars. The expansion hit implementing states with a double whammy of higher-than-projected per-enrollee spending and higher-than-projected enrollment. In states that provide data, enrollment has exceeded projections by an average 91 percent and exceeded maximum-enrollment projections by an average 73 percent.

The 19 states that refused to participate in the Medicaid expansion are looking wiser all the time. Indeed, according to projections by the Urban Institute, by refusing to implement the Medicaid expansion, those 19 states will reduce federal spending, deficits, and debt by $349 billion by 2022.

A Drag on the Economy

The ACA imposes a series of explicit and hidden taxes that inhibit economic productivity and trap Americans in low-wage jobs. Economist Casey Mulligan writes:

> The ACA makes health care more affordable for segments of the population, but in doing so it makes health care less affordable for the nation as a whole. The ACA will have the nation working fewer hours, and working those hours less productively, so that its nonhealth spending will be twice diminished: once to pay for more health care and a second time because the economy is smaller and less productive.

The ACA imposes $1.2 trillion in new explicit taxes through 2022. Some will not take effect until 2020. According to one estimate, the ACA's explicit taxes alone could reduce economic output by as much as $750 billion in just the first six years. The Congressional Budget Office estimates the ACA will eliminate roughly 800,000 jobs. The law has caused employers to cut hours for everything from waiters to college professors.

A Low-Wage Trap

Rather than freeing workers to pursue their dreams, the ACA traps workers in low-wage jobs. The ACA withdraws health insurance subsidies as earnings rise. The prospect of losing subsidies discourages workers from increasing their earnings in the same way an explicit tax does.

Mulligan estimates the combined effect of the ACA's explicit and implicit taxes is a six percentage point increase in the average implicit marginal tax rate that workers face. For some workers, the ACA creates implicit marginal tax rates of 100 percent or more. If those workers increase their earnings—if they get a college degree, work more hours, or take a better paying job—they pay so much more in taxes and lose so much in government subsidies that their incomes fall. All told, the ACA creates larger disincentives to work than any other piece of legislation Congress

enacted in the previous seven decades. Under the ACA, many workers get less when they work more and can increase their incomes by working less.

An Illegitimate Law

Together with the law's content, the conduct of its supporters has made the ACA one of the most unpopular and divisive laws in recent history. Supporters used calculated deceptions to secure its passage. The executive branch and Supreme Court stepped outside the law to protect the ACA from constitutional infirmities and democratic accountability. Those actions deepened partisan divisions, hardened opposition to the ACA, sowed distrust in government broadly and the Court in particular, strained the rule of law, and make repeal all the more imperative.

During President Obama's 2008 inauguration, at which point he still opposed an individual mandate, polls showed that voters broadly approved of his plans to reform health care. Public opinion began to turn as more details emerged. When House Democrats released the first draft of the ACA in June 2009, public support turned to opposition. The ACA has been consistently unpopular with the American public since its authors first introduced it as legislation.

Supporters both blunted and fueled opposition to the ACA by using calculated deceptions to secure passage. President Obama and others repeatedly promised that all Americans could keep their health plans—a promise they knew to be untrue. Well after enactment, ACA architect Jonathan Gruber admitted that he and other architects deliberately wrote the law in a manner that hides its costs from those who are paying them, and that those deceptions were crucial to passage. ACA supporters often claim, "The more [people] find out about it, the more they like it." Gruber admitted the opposite is true: if people had known more about the ACA, the opposition would have been greater, and it would not have passed Congress.

The ACA triggered a backlash that led to Republican gains in 2010 and 2014 and led many states to refuse to implement an exchange or the Medicaid expansion. Congress has held dozens of votes to repeal the ACA in whole or in part. A Republican Congress and President Obama together repealed the law's long-term care entitlement, repealed various burdens it imposed on employers, and curtailed its bailouts of taxpayer-financed health-insurance "co-ops" and private insurance companies. In 2016, two years after the ACA supposedly became politically invulnerable, Congress sent to President Obama a bill that repealed a majority of the law's major

provisions, and that would have effectively forced Congress to reopen or repeal the remaining provisions.

The durability of public opposition to the ACA is even more remarkable when we consider its authors crafted the law to purchase, with taxpayer dollars, the support or silence of every concentrated industry group that might have opposed it. Supporters believe the ACA makes health care more affordable and sides with consumers against greedy pharmaceutical and insurance companies. In fact, the ACA is a $2 trillion special-interest bonanza for "Big Pharma," private insurance companies, and providers. To an extent, the strategy worked. No corner of the health care sector opposes the ACA.

Still, for the ACA to survive, the Supreme Court had to alter it twice to save it from unconstitutionality, and a third time to save it from the voters. In *NFIB v. Sebelius*, the Supreme Court found the ACA on its own terms was unconstitutional in two different respects. Rather than strike down the admittedly unconstitutional law, the Court stepped into Congress's shoes and altered the law's terms. In *King v. Burwell*, a unanimous Supreme Court acknowledged the executive branch was taxing and spending billions of dollars to prop up the ACA contrary to the terms of the act. Rather than uphold the terms of the law Congress approved, the Court again assumed Congress's role and altered those terms.

The executive branch continues to violate the law in order to prop up the ACA. A federal court has ruled the Obama administration "violate[d] the Constitution" by sending billions of dollars to private insurance companies participating in the exchanges. The Government Accountability Office ruled the executive branch diverted a further $3 billion to insurers in a manner "inconsistent with the plain language of the statute."

If the government is not bound by the express terms of the ACA, it is difficult to argue that the people should be. The ACA's illegitimacy makes repeal all the more imperative.

States

As discussed in Chapter 39, there is little reliable evidence that Medicaid improves the health of enrollees and no reliable evidence that it is a cost-effective way of doing so. States that have not implemented the Medicaid expansion should continue to refuse. States that have expanded Medicaid should withdraw from the expansion. All states should petition the federal government for greater flexibility in the use of Medicaid and State Children's Health Insurance Program funds, including the authority to conduct

large, randomized studies of the effects of Medicaid coverage on health and other outcomes for existing eligibility groups.

Furthermore, all states should adopt reforms that will make health care better, more affordable, and more secure. These reforms include liberalizing the licensing of clinicians and health insurance and reforming medical malpractice liability rules (see Chapter 35).

Congressional Oversight Hearings

The more the public hears from victims of the ACA, the more support for repealing the ACA will grow. Congress can educate the public about the ACA by holding oversight hearings. Witnesses should include Americans whose coverage was canceled (for the various reasons discussed here), whose premiums make health insurance unaffordable, and—especially—patients with high-cost conditions whom the ACA subjects to narrow networks and high cost-sharing designed to be unappealing to the sick.

Repealing the ACA

Repealing the ACA should be the first item on Congress's health reform agenda, and Congress should not stop trying until it succeeds. The ACA may not be the most harmful way the government has intervened in the health care sector—even with all the damage it is causing. That distinction could belong to Medicare (see Chapter 38), the tax exclusion for employer-sponsored insurance (see Chapter 37), or quite possibly government licensing of clinicians (see Chapter 35). Nevertheless, repeal of the ACA deserves the immediate attention of Congress because the law is the most politically unpopular and vulnerable of any major government intervention in health care.

Americans under age 65 will never have secure access to health care as long as the ACA's health insurance regulations, mandates, and subsidies remain on the books. Congress need not eliminate the ACA's other provisions—its spending cuts and tax increases—though including those provisions in a repeal bill may be necessary to expand the repeal coalition.

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—Prepared by Michael F. Cannon

5. Federal Tax Reform

Congress should

- replace current individual income tax rates with rates of 15 and 25 percent;
- cut the top dividend and capital gains tax rates to 15 percent;
- repeal virtually all deductions and credits;
- cut the corporate income tax rate to 15 percent;
- create universal savings accounts so that all families can build wealth without double taxation;
- replace business depreciation with capital expensing;
- take reforms further by replacing the income tax with a consumption-based flat tax;
- repeal the individual and corporate alternative minimum taxes; and
- repeal the estate tax.

At the beginning of the 20th century, federal taxes accounted for 3 percent of the nation's gross domestic product (GDP), and federal tax rules filled just a few hundred pages. Today, federal taxes account for more than 18 percent of GDP, and federal tax rules span 75,000 pages, according to tax analysis firm CCH Inc. The federal government will extract $3.5 trillion in taxes from families and businesses in 2017. Individuals will be left with less income to buy food, clothing, and other needed items, while businesses will be left with less income to hire workers and build factories.

Federal taxation is costly in other ways as well. The tax code's complexity creates a large paperwork burden and makes financial planning more difficult. Tax complexity also breeds confusion and distrust about the cost of government and who bears the burden. Another cost of the tax system

is the damage to economic growth. High tax rates reduce productive activities, such as working and investing, and the unequal tax treatment of different industries and activities steers resources into low-value uses.

Congress should cut spending to reduce the overall burden of taxes, and it should reform the tax code with three goals in mind: simplification, transparency, and increased economic growth. Fundamentally, taxes should be lower, flatter, and simpler, and reforms should move in that direction.

Simplification

In 1976, president-to-be Jimmy Carter called for "a complete overhaul of our income tax system. I feel it's a disgrace to the human race." Since that call for reform, the number of pages of federal tax rules has tripled, according to CCH. Congress continues to create new deductions, credits, and penalties, while the Treasury Department churns out an endless stream of regulations. Tax complexity creates at least five costs:

1. Compliance burdens. Americans spend more than 6 billion hours annually filling out tax forms, keeping records, and learning tax rules, according to the Office of Management and Budget. The paperwork for a corporate tax return can be 10,000 pages in length. In addition to the costs of filing, taxpayers face a burden from audits, notices, liens, levies, seizures, and the millions of penalties assessed each year by the Internal Revenue Service (IRS). Complying with the federal tax code costs the economy hundreds of billions of dollars annually.

2. Errors. Tax complexity causes taxpayers and the IRS to make frequent and costly errors. The IRS does an awful job in accurately answering phone queries from taxpayers. But that is mainly the fault of Congress for larding up the tax code with hundreds of special breaks and penalties for individuals and businesses, including the complicated tax-filing rules under the Affordable Care Act.

3. Economic decisionmaking. Tax complexity impedes efficient decisionmaking. For example, if a family chooses the wrong vehicle for its savings, that decision could result in higher taxes, lower returns, less liquidity, or penalties on withdrawals. For businesses, tax complexity injects uncertainty into hiring, capital investment, and other important decisions.

4. Inequity and unfairness. Although equality under the law is a bedrock principle of justice, individuals pay greatly different tax rates under the income tax. For example, IRS data for 2013 show that income taxes averaged 27 percent of adjusted gross income for the top 1 percent

of households compared with 14 percent for taxpayers overall. At the same time, people with similar incomes are treated unequally as a result of exemptions, deductions, and credits in the tax code related to education, home ownership, and other items.

5. Avoidance and evasion. Tax complexity leads to greater noncompliance with the tax system. Noncompliance stems from confusion over the tax rules and aggressive tax planning. People take more risks on their tax returns when rates are high, and complexity hides their strategies from the IRS. If the tax code had low rates and a simple base, individuals and businesses would focus on productive activities rather than tax avoidance.

Transparency

A simple and transparent tax system would give citizens a clear picture of the burden of government. If the federal government imposed only a single tax at a single rate, people could more easily compare the cost of government with the costs of other items in their budget, such as food and housing.

Unfortunately, policymakers use numerous techniques to hide the burden of government. They run deficits, which defers taxes until the future and makes a share of today's spending seem free. They collect income and payroll taxes through employer withholding to make paying taxes less painful. And they conceal the size of the overall tax load by spreading the burden across multiple tax bases.

Policymakers also hide the tax burden from citizens by collecting taxes from businesses. The largest hidden tax is the "employer" half of the 15 percent payroll tax that funds Social Security and Medicare. That tax is not reported on worker paystubs, but economists agree that the burden falls on workers in the form of lower wages. Another hidden tax is the corporate income tax, which is passed through to individuals in the form of higher prices, lower wages, and reduced returns on savings. Together, deficits, the corporate income tax, and the employer half of the payroll tax hide from individuals more than one-third of the cost of federal spending. The result is that people perceive the "price" of federal spending to be artificially low, and they "demand" too much of it.

Reforms should make the federal tax structure simpler, flatter, and more transparent so people can understand the cost of government. For example, the entire payroll tax should be shown on worker paystubs and W-2 tax forms so that people can more readily see the costs of Social Security and Medicare. For the income tax, the current mess of multiple rates and

narrow breaks should ultimately be scrapped in favor of a simple flat tax. All taxpayers should pay an equal share of their earnings to the government above a basic exemption amount. That would create greater "solidarity" among taxpayers because a proposed rate increase would hit everyone equally. With equal treatment, there would be greater opposition to tax increases, especially if people believed that they were not getting good value from their government.

Economic Growth

American incomes would be higher and growth more robust if the overall size of the federal government was reduced. But it is also true that for any particular size of government, the economy would be stronger if marginal tax rates were lower and the tax base was simpler and more neutral. Such reforms would minimize tax distortions that undermine working, saving, investing, and entrepreneurship.

The income tax distorts productive activities, thereby creating "deadweight losses." The size of such losses rises rapidly as marginal tax rates rise. Harvard University's Gregory Mankiw explains, "It is a standard proposition in economics that the deadweight loss of a tax rises approximately with the square of the tax rate. . . . If we double the size of a tax, the deadweight loss increases four-fold." Thus, a low-rate tax structure is much less damaging than a high-rate structure, and cutting the highest rates would create the largest benefits. People with high incomes often have unique talents, and they may respond strongly to tax rate changes. Tax increases on high-earning doctors, for example, may cause them to reduce their work hours or retire earlier, which would hurt patients and the overall economy.

Policymakers should also keep in mind that there is a high concentration of small businesses in the top income tax brackets. About three-quarters of the top 1 percent of federal taxpayers report some small business income, and these taxpayers often have flexibility in adjusting their reported income with changes to their working and investing activities.

The upshot is that for every $1 billion tax increase, the harm to the private economy is more than $1 billion because of the losses caused as taxpayers reduce their productive efforts. The Congressional Budget Office found that "typical estimates of the economic [or deadweight] cost of a dollar of tax revenue range from 20 cents to 60 cents over and above the revenue raised." Harvard University's Martin Feldstein estimates that the

deadweight cost of tax rate increases may exceed "one dollar per dollar of revenue raised."

Aside from reducing tax rates, tax reforms should reduce the tax code's bias against savings and investment. That bias reduces the size and quality of the nation's capital stock, which in turn reduces worker incomes. Tax reforms should transition from an income tax base to a consumption base—a base that is neutral with respect to savings and investment. For businesses, the tax code can be moved toward a consumption base by substituting capital "expensing" for depreciation. Under expensing, businesses would immediately deduct the costs of equipment and structures they purchased, rather than deducting the costs over a period of years. For individuals, the tax code can be moved toward a consumption base by enacting universal savings accounts (USAs) like those introduced by Sen. Jeff Flake (R-AZ) and Rep. David Brat (R-VA) in 2015. Contributions to USAs would come from after tax income, and all account earnings would be tax free. Individuals could withdraw funds tax free at any time for any reason, which would increase liquidity and encourage saving. Both Great Britain and Canada have enacted such accounts, and they have been hugely popular. USAs would encourage people to build larger nest eggs and increase their personal financial security.

Tax Reform Steps

To reform the complex and burdensome U.S. tax code, Congress should take the following steps:

- **Simplify the tax-rate structure**. The current income tax structure of seven rates should be collapsed to two rates of 15 and 25 percent.
- **Cut dividend and capital gains rates**. Corporate equity is currently taxed at both the corporate and individual levels, which biases the tax code in favor of debt. To alleviate this distortion and encourage investment, Congress should cut the top individual tax rates on dividends and capital gains to 15 percent.
- **End most deductions and credits**. Special-interest tax breaks—including the mortgage interest deduction, the state and local tax deduction, the exclusion for interest on state and local government bonds, and virtually all tax credits—should be repealed.
- **Cut the corporate tax rate to 15 percent**. According to the international auditing firm KPMG, the global average corporate tax rate is 24 percent, which is far lower than the combined U.S. federal-state

rate of 40 percent. Congress should slash the federal rate of 35 percent to 15 percent, which would match the federal rate in Canada. Interestingly, Canada collects about the same amount of corporate taxes as a share of GDP as we do, partly because the low Canadian rate reduces tax avoidance and increases investment.

- **Expand capital expensing**. Congress has enacted a number of temporary measures in recent years allowing companies to expense a portion of their capital purchases. Congress should enact full and permanent capital expensing, which would boost investment and productivity, and in turn raise worker wages.
- **Enact universal savings accounts**. Congress should enact all-purpose savings accounts, USAs, which would combine tax-free accumulation with tax-free withdrawals at any time for any reason. USAs would encourage families to build up nest eggs that could be used for any purpose, such as medical and college expenses, buying a home, covering spells of unemployment, or starting a business. All personal savings—not just retirement savings—should be encouraged.
- **Repeal the estate tax**. The federal estate or "death tax" has a top rate of 40 percent. It raises less than 1 percent of federal revenues but creates substantial economic damage. It reduces savings and has created a wasteful estate planning industry to help people avoid it. The death tax may not actually raise any money for the government, on net, because it suppresses income tax collections. Mankiw concluded that "estate tax repeal . . . could actually increase total federal revenue," noting that "repeal of the estate tax would stimulate growth and raise incomes for everyone."
- **Enact a consumption-based flat tax**. In recent decades, proposals to replace the federal income tax with a consumption-based flat tax have gained support. Such reforms would simplify taxation, increase savings and investment, and spur growth. The reform steps discussed here would move the United States toward a low-rate consumption-based system. About two dozen nations have enacted flat tax systems, as discussed in *Global Tax Revolution*. America should join this "flat tax club" to increase fairness and revitalize the economy.

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—Prepared by Chris Edwards

6. Reviving Growth

Congress should

- recognize that the U.S. economy has experienced a downward shift in the long-term rate of growth, with the pace of growth one-half to two-thirds that of the 20th century;
- understand the huge impact of the growth slowdown: if current growth rates persist, a person born in 2000 will spend her retirement years in an economy half as big as it would have been if 20th-century growth rates had been maintained;
- recognize that reversing the growth slowdown should be a top priority across the political spectrum, as disagreements about how to divide the economic pie are subordinate to the common interest in a larger pie;
- understand that policy changes can have a significant positive effect on the long-term rate of growth; and
- seek out pro-growth reforms that attract support across the political spectrum, so that the common interest in higher growth is not a casualty of partisan polarization.

The 21st century has witnessed a major downward shift in the trajectory of U.S. economic growth. From 1900 to 2000, real (i.e., inflation adjusted) gross domestic product (GDP) per capita rose at an average annual rate of 2.1 percent. The long-term growth path remained remarkably steady even in the face of massive macroeconomic fluctuations. For example, over the 20 years from 1929 to 1949—a period that encompassed the twin convulsions of the Great Depression and World War II—the average growth rate clocked in at 2 percent per year, right on trend.

In contrast, from 2000 to 2015, annual growth in real GDP has averaged only 1 percent—half the rate of 20th-century growth. At the center of

this story is the Great Recession of 2007–2009 and its aftermath. Between the fourth quarter of 2007 and the second quarter of 2009, U.S. GDP shrank by 4.2 percent—the sharpest decline since the Great Depression. Normally in U.S. economic history, severe recessions are followed by vigorous recoveries, but not this time. Instead, the economy experienced its weakest expansion since World War II. As of October 2013, 70 months after the recession began, real GDP had grown only 5.3 percent. In contrast, after the prior six recessions, real GDP growth averaged a robust 20 percent over the same period of time.

For most Americans, the economy has been performing even worse than these aggregate numbers suggest. With the rise in income inequality, the benefits of growth in terms of rising incomes are now skewed toward the upper reaches of the socioeconomic scale. As a result, most Americans have been experiencing not just a slowing rate of improvement, but stagnation and even decline. Real median household income (family income for Americans in the exact center of the income distribution) was 7 percent lower in 2014 than it was in 2000. Using different adjustments for inflation, it is possible to massage those figures to make them look slightly less bleak. It is impossible to massage them into looking good.

The "New Normal" of Slow Growth

Unfortunately, the economy's sluggishness is likely to persist. At a Cato Institute conference in December 2014, two of the nation's leading experts on productivity growth presented long-term growth projections for the U.S. economy. Dale Jorgenson of Harvard University projected annual growth in aggregate real GDP of 1.75 percent, while John Fernald of the Federal Reserve Bank of San Francisco projected a slightly faster growth rate of 2.1 percent. After taking account of likely population growth, Jorgenson's projection puts annual growth in real GDP per capita at below 1 percent, while Fernald's comes in under 1.4 percent. In other words, in Fernald's more optimistic scenario, growth in the years to come will be more than a third off its 20th-century pace, while in Jorgenson's scenario, the long-term growth rate has been cut in half.

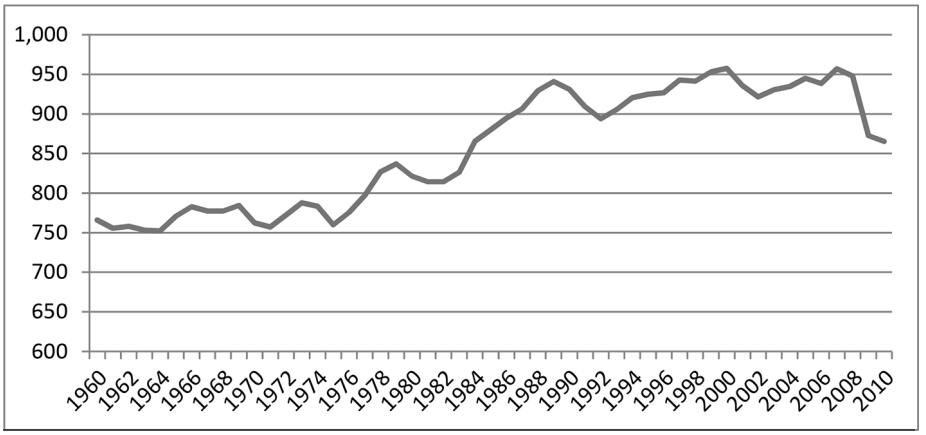
The reasons for Jorgenson and Fernald's pessimism have nothing to do with any recent events—neither lingering effects from the severe recession nor problems with policies enacted in its wake. Rather, both recognize the impact of deep-seated factors that once propelled growth but that now have shifted in an unfavorable direction.

To understand what's going on, let's break down measured economic growth into the constituent elements tracked by conventional growth accounting: (1) growth in labor participation, or annual hours worked per capita; (2) growth in labor quality, or the skill level of the workforce; (3) growth in capital deepening, or the amount of physical capital invested per worker; and (4) growth in so-called total factor productivity, or output per unit of quality-adjusted labor and capital.

Over the course of the 20th century, these various components fluctuated in their contributions to overall growth. The fluctuations, however, tended to offset each other, so that the long-term trend line of growth overall remained stable. In the 21st century, however, this pattern of offsetting fluctuations has come to a halt as all growth components have fallen off simultaneously.

One way to get faster growth is for more people to work or for people to work longer hours. Between the mid-1960s and 2000, average annual hours worked per capita surged from under 800 to above 950, powered by rising labor force participation among women and the influx of baby boomers into the work force. Since 2000, however, the labor force participation rate for both men and women has been in steep decline: from its overall peak of 67.3 percent in early 2000, it has dropped all the way to 62.7 percent as of June 2016, the lowest rate since 1978 (Figure 6.1).

Figure 6.1
Average Annual Hours Worked per Capita



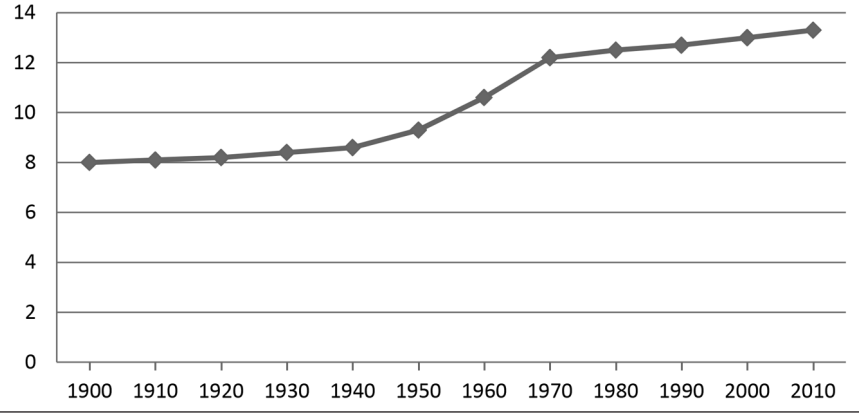
SOURCE: Data from 1900–2005 come from Valerie Ramey, http://www.econ.ucsd.edu/~vramey/research.html. Data from 2006–2010 are a recreation of Ramey's methods using Current Population Survey civilian hours plus Ramey's military figures divided by the U.S. Census's annual population figures.

With labor hours shrinking, output per worker hour (otherwise known as labor productivity) has to rise just to keep the economy from shrinking. Accordingly, hours worked per capita has gone from providing a strong tailwind for growth to now resisting growth with a stiff headwind.

While the quantity of labor supplied is an important factor in determining output, so is the quality of labor. Since workers with higher skills and more experience produce more output in a given hour than do their less skilled, more junior colleagues, boosting the skill level of the workforce is an important way to create economic growth. Over the course of the 20th century, huge investments in mass schooling—first at the secondary level, then at the postsecondary level—led to a much more highly skilled workforce. Harvard economists Claudia Goldin and Lawrence Katz estimate that rising educational attainment accounted for about 15 percent of total growth over the period 1915–2005. But the rate of increase in years of schooling per worker has slowed dramatically in recent decades: the pace of improvement between 1980 and 2005 was less than half that during the period between 1960 and 1980 (Figure 6.2). And looking ahead, the educational level of the workforce is expected to plateau. Another important source of growth has therefore petered out.

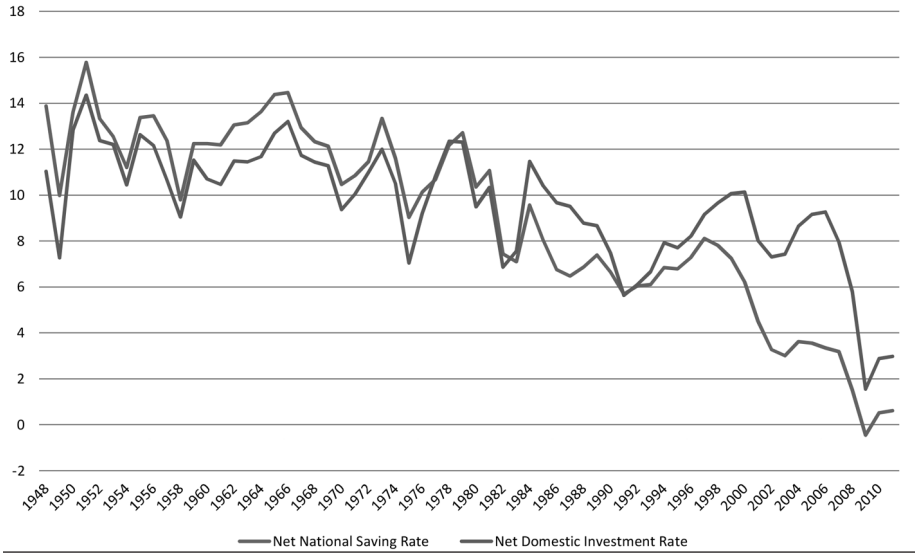
An additional source of growth is investment: workers with more and better tools are able to produce more. Unfortunately, net national invest-

Figure 6.2
Average Years of Schooling



SOURCE: 1900–1939: "120 Years of American Education: A Statistical Portrait" found at http://0-nces.ed.gov.opac.acc.msmc.edu/pubs93/93442.pdf. 1940–1990: Current Population Survey of the BLS Table A-1. 2000–2010: UNDP, http://hdrstats.undp.org/en/indicators/103006.html.

Figure 6.3
Saving and Investment Shares

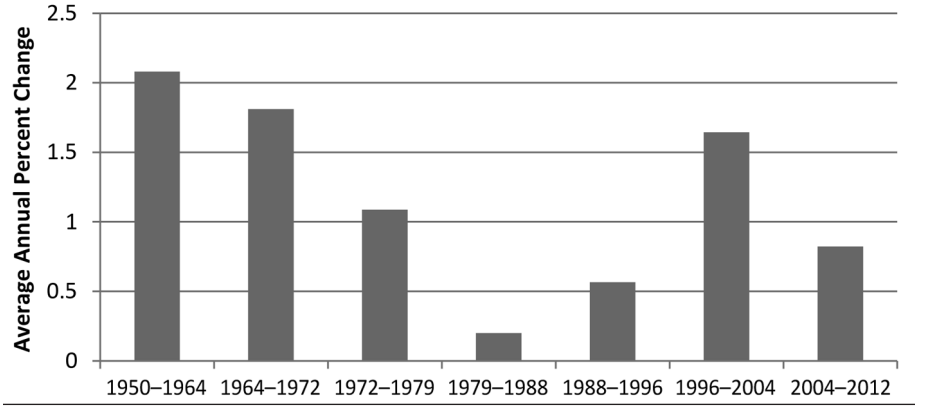


SOURCE: Jagadeesh Gokhale, Cato Institute.

ment (investment net of depreciation charges) as a percentage of net national product has been falling for decades, dragged down by the more widely reported drop in the national savings rate (Figure 6.3). There is therefore no current basis for expecting a surge in investment to counteract the unfavorable trends regarding hours worked and educational attainment.

In the case of labor hours, worker skills, and investment, growth is created by adding more inputs. If you increase inputs with more hours worked, more training, and more equipment, then you will produce more output. The final source of growth, innovation, involves figuring out how to get more output from a given set of inputs—either through inventing new products or by developing more efficient production processes. Economists' best measure of innovation is known as total factor productivity (TFP) growth: the increase in output from a given unit of labor and capital. From 1996 to 2004, TFP growth surged after a long slump that began in the 1970s; since 2004, however, TFP growth has returned to the low rates of decades past (Figure 6.4). Admittedly, shifts in the rate of TFP growth are unpredictable, so it is possible that another round of rapid growth is just around the corner. But at present, no signs of such a turnaround are visible.

Figure 6.4
Total Factor Productivity



SOURCE: 1871–1950: Robert Gordon's 1999 "U. S. Economic Growth Since 1870: One Big Wave." 1950–2011: The Bureau of Labor Statistics, "MFP Tables: Historical multifactor productivity measures (SIC 1948–87 linked to NAICS 1987–2011)," Nonfarm Tables, June 2013, http://www.bls.gov/mfp/.

In the 21st century, the U.S. economy has thus experienced simultaneous weakening in all four components of economic growth. This does not mean that slow growth is inevitable from here on out: the current trends are not set in stone. Nevertheless, it is difficult to avoid the conclusion that the conditions for growth are less favorable than they used to be.

The Stakes Are High—for Left and Right Alike

The long-term implications of a 50 percent drop in the growth rate are huge. With real GDP per capita rising 2 percent a year, output per capita doubles in around 35 years. With the growth rate cut to 1 percent, doubling takes 70 years. Accordingly, if 21st-century growth rates persist, a person born in 2000 will spend her old age in an economy only half as rich as it would have been if 20th-century growth rates could have been extended.

Conservatives and libertarians should require little convincing that more economic output is generally something to be desired, and that therefore the prospect of a prolonged growth slump is a matter of serious concern. Progressives may be more skeptical. In particular, they might object that, because of income inequality, all the extra output created by higher growth wouldn't translate into commensurate income gains for most Americans.

That's an understandable concern, but disappointment with the pace of median income growth will hardly be assuaged by a slowdown in the economy's overall expansion. In the era of rising inequality and falling median wage growth that began in the 1970s, there has been only one period of strong growth in real earnings: the late 1990s, when GDP and productivity growth were surging as well. Thus, even in an age of income inequality, faster growth redounds to the benefit of average workers. Indeed, in the current circumstances, it appears that only strong growth can stave off stagnation or disappointingly sluggish growth in workers' pay.

Many progressives might argue that, even with faster growth, the gains from economic growth are no longer shared widely enough. More redistribution, they contend, is needed to correct the imbalance. Libertarians and conservatives can be counted on to dispute the point, but that is an argument for another day. For present purposes, it suffices to point out that slow growth will make it all but impossible to fund any more generous provision for the less well-off.

Because of the aging U.S. population and rising health care spending, entitlement spending on the elderly figures to put the squeeze on everything else the federal government does. According to the Congressional Budget Office, spending on Social Security and the major federal health care programs is projected to balloon to 14 percent of GDP by 2039, double the 7 percent average over the past 40 years. Meanwhile, spending on everything besides interest payments would fall to 7 percent of GDP, well below the 11 percent 40-year average—indeed, a smaller share of GDP than at any time since the late 1930s. And even with this hit to the relative size of nonentitlement spending, by 2039, federal debt as a share of GDP is projected to hit the all-time historical peak of 106 percent (set back in 1946 at the end of World War II). It will continue upward from there. To put it mildly, this is not a fiscal environment that augurs well for big new federal social programs.

Alas, we cannot simply grow our way out of this predicament. Yes, higher growth directly inflates the denominator of the debt-to-GDP ratio; but it also leads to increased spending under entitlement programs and thus works indirectly to boost the numerator as well. Nevertheless, faster growth does mean a considerably larger economy over the longer term and, consequently, more resources available for funding income transfers than would otherwise be the case.

Consequently, progressives and libertarians should be united on the desirability of higher growth. They may have different ideas about what

to do with the extra money, but both sides have a stake in getting the chance to fight it out.

In addition to economic reasons for favoring higher growth regardless of ideology, there are also important political reasons. Indeed, in our present situation, the political stakes have assumed an urgency that swamps any calculations of mere dollars and cents. The health of American democracy and the basic character of American society are now on the line. As Harvard economist Benjamin Friedman documented in *The Moral Consequences of Economic Growth*, a prosperous, growing economy promotes the democratic virtues of tolerance and openness. When incomes and living standards are rising generally, the welfare of other groups is less likely to be perceived as a threat to one's own. But when the economy stagnates, gains for some necessarily mean losses for others. In this zero-sum environment, the ugly, defensive reactions of bigotry, xenophobia, and belligerent nationalism gain traction.

With the recent rise of authoritarian populism here in the United States, as well as in countries across Europe, the broader, political implications of the growth rate are no longer a matter of merely theoretical concern. Fundamental American ideals are under active assault, and all who still hold to those ideals, regardless of their position on the political spectrum, need to recognize the role that the growth slowdown is playing in strengthening the other side. Reviving economic growth is perhaps the most potent means at our disposal to counter and defeat this illiberal challenge to the country's founding principles.

Reversing the Growth Slowdown

Can anything be done to stir the economy out of its current doldrums? The heartening answer is yes, absolutely. Current trends in labor participation, labor quality, investment, and innovation point to a permanent reduction in the U.S. economy's long-term growth path, but those trends do not exist in a vacuum. They are situated in the larger context of the nation's laws and economic policies, which combine to shape the incentives of individuals and firms along countless different margins. If you change those laws and policies, then you can change those incentives; change those incentives, and you can change the economic trends.

The fact is—and it's hard to imagine who would disagree—that American public policy is far from optimal when it comes to facilitating economic growth. Look at the factors that shape each component of growth and you will find laws and policies that push in the wrong direction: laws

and policies that discourage participation in the labor force, frustrate accumulation of human capital, deter productive investment, and inhibit innovation or block its diffusion throughout the economy. In the circumstances, this is good news: it means that there is wide room for improving public policy, and consequently wide room for improving economic performance.

To explore the wide variety of possible pro-growth reforms, the Cato Institute hosted a special online forum during late 2014, in which 51 of the nation's top economists and policy experts were asked to identify one or two policy changes that could trigger faster economic growth, whether temporarily through a one-time change in the level of output or indefinitely through accelerating the growth rate. The proposed reforms covered a long list of policy domains: tax policy; budget policy; education and training policy; health care financing policy; financial regulation; monetary policy; health, safety, and environmental regulation; regulations on starting a business; trade policy; immigration policy; intellectual property law; land use regulation; and even foreign policy. In addition, some of the contributors have advocated what might be called "meta policy" changes—that is, reforms to the policymaking process rather than specific substantive changes to rules or programs.

While everyone might agree on the need to change public policy, finding agreement on what particular changes to make is considerably trickier. After all, American politics today is characterized by deep ideological divisions and intense partisan polarization over government's proper role in the economy. There are many fronts in the political conflicts of recent years: the trajectory and composition of federal spending, the level and structure of taxation, health care policy, regulation of the financial sector, immigration, climate change, and environmental regulation more generally. All involve policy issues with important implications for the level of output or the permanent rate of growth. On these questions, and many others besides, the respective sides are miles apart when it comes to the proper direction of policy change. Yes, there is a shared interest in continued healthy economic growth that transcends the left-right divide. But agreement on ends need not translate into agreement on means, and in the present case, there is disagreement aplenty.

Under current political conditions, the most promising path forward is to identify policy ideas that are not already the subject of high-profile, politically polarized debate. America's growth slowdown is a new problem, and policy responses that address that problem are more likely to gain

traction if they are not recycled ideas originally put forward to address other problems. And if a policy idea is already clearly associated with either the left or the right, in today's highly contentious environment, it is all but guaranteed that the other side will fight tooth and nail against it. That makes progress of any kind difficult in the absence of large congressional majorities and unified partisan control of the White House and Congress.

The good news is that, notwithstanding the extent of polarization, it is still possible to construct an ambitious and highly promising agenda of pro-growth reforms that steers largely clear of the red-versus-blue divide. Chapter 7 explains how.

Suggested Readings

Friedman, Benjamin. *The Moral Consequences of Economic Growth*. New York: Vintage Books, 2006.

Lindsey, Brink. "Why Growth Is Getting Harder." Cato Institute Policy Analysis no. 737, October 18, 2013.

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Lindsey, Brink, ed. *Reviving Economic Growth: Policy Proposals from 51 Leading Experts*. Washington: Cato Institute, 2015.

———. *Understanding the Growth Slowdown*. Washington: Cato Institute, 2015.

—Prepared by Brink Lindsey

7. Regressive Regulation

Congress should

- eliminate or reduce criminal penalties for copyright infringement and stop the use of civil asset forfeiture in infringement cases;
- end all liability for noncommercial copying;
- substantially reduce copyright terms;
- end patent protection for software and business methods;
- enact procedural reforms to limit abusive litigation by "patent trolls";
- increase the number of green cards awarded on the basis of worker skills, educational attainment, and economic value;
- end country-specific caps on green cards for highly skilled immigrants;
- raise the cap for H-1B visas and eliminate restrictions that lessen their value;
- mandate the recognition of valid occupational licenses in all states;
- authorize interstate compacts on mutual recognition of licenses; and
- eliminate antitrust immunity for state licensing boards dominated by private-sector members.

As Chapter 6 demonstrated, reviving economic growth is an urgent task with appeal across the political spectrum. But given the current polarization of American politics, is it really possible to unite left and right on a common approach to achieving this shared goal?

Yes, it is possible—and seizing this possibility offers a promising opportunity to reverse the growth slowdown through policy change. To pursue

a truly "transpartisan" pro-growth reform agenda, Congress should focus on changing policies whose primary effect is to inflate the incomes and wealth of the rich, the powerful, and the well-established by shielding them from market competition. To apply a convenient label, let's call these policies "regressive regulation"—regulatory barriers to entry and competition that work to redistribute income and wealth up the socioeconomic scale.

Avoiding Polarization and Gridlock

A policy agenda of reforming regressive regulation can take advantage of an ideological no-man's-land in contemporary American politics. Conservatives tend to valorize business and the well-off ("job creators") and take a dim view of government regulators ("bureaucrats"); progressives, meanwhile, identify with government regulators ("public servants") and the disadvantaged, while casting a suspicious eye toward business and the successful ("plutocrats"). Regressive regulation scrambles these ideological loyalties, and the effect is to mute both support for and opposition to such policies along ideological lines. Conservatives generally cheerlead for deregulation, but they don't tend to focus on the regulations that favor their constituencies. Progressives, on the other hand, instinctively defend regulation as necessary and beneficial, but that impulse weakens considerably when regulation's obvious effect is to entrench privilege and deepen disadvantage.

This peculiar state of affairs, in which ideological passions on both sides are substantially neutralized, creates an opening to cut through the prevailing polarized gridlock and effect significant policy change. Here the main conflict is not between the left and right's conflicting visions of the public interest. Instead, there is a fairly robust intellectual consensus on where the public interest lies: economists, whether they tend to vote Republican or Democratic, are likely to support reform—the status quo has few disinterested defenders. In the case of regressive regulation, the conflict can thus be persuasively framed as the perennial one between the public interest and private privilege. The only vociferous supporters that these policies can count on are the narrow interest groups that are profiting from them at the expense of the rest of us.

These circumstances suggest that the reform and repeal of regressive regulation now represent the most promising way to reinvigorate the U.S. economy's long-term growth prospects. The economic evidence is strong that dismantling barriers to entry and competition can have a significant

impact on both the level of total output and the permanent rate of output growth. Meanwhile, efforts to reform those barriers that redistribute wealth and income upward can take advantage of a political environment relatively free of the polarized ideological conflict that now plagues policymaking in so many other domains. In other words, the economic gains are large and the political conditions for realizing those gains are relatively favorable.

Three policy areas in particular offer inviting targets for action by Congress: (1) excessive protection of copyrights and patents; (2) restrictions on high-skill immigration; and (3) protection of incumbent service providers through occupational licensing.

Intellectual Property

Copyright and patent laws are supposed to promote innovation and growth by granting temporary monopolies that raise the return on producing new ideas. But copyrights and patents impose costs as well as confer benefits. First, they raise the price of protected goods and thereby burden consumers with a deadweight loss. Second, by helping some innovators, they end up hurting others. Innovation frequently occurs through borrowing and adapting others' ideas; by restricting access to those ideas, copyrights and patents raise the cost of innovation and thus push in the direction of slower growth. In recent years, the costs imposed by copyright and patent law have escalated dramatically: in the case of copyright, through the wildly excessive extension of copyright terms, criminalization of copyright violations, and ongoing hostility to new copying technologies that may be used to reproduce copyrighted material; in the case of patents, through the extension of patent protection to vaguely defined innovations in software and business methods, and the rise of "patent trolls" that buy up patent portfolios and monetize them through litigation. Because of these ill-advised developments, these laws now cause a significant drag on innovation and growth.

There is much that Congress could do to improve intellectual property law. Regarding copyrights, Congress should end or reduce criminal penalties for copyright infringement, stop the use of civil asset forfeiture in infringement cases, end any liability for noncommercial copying, and significantly reduce the term of copyright protection from the absurdly over-long present term of life plus 70 years. As for patents, Congress should simply end patent protection for software and business methods, where patents have been so badly abused; failing that, Congress should implement procedural reforms to limit abusive litigation by "patent trolls."

High-Skill Immigration

Immigrants are a major catalyst of U.S. entrepreneurship and innovation. According to one study of a large sample of engineering and technology companies founded between 1995 and 2005, 25 percent of those companies had at least one foreign-born founder. Yet current immigration laws make it very difficult for such highly talented individuals to live and work in our country. Out of roughly 1 million permanent resident visas awarded each year, only about 70,000 go to individuals on the basis of their work skills or economic value. Temporary visas allow about 650,000 high-skilled workers to reside in the United States at any given time—a mere 0.4 percent of the workforce.

There are many possible steps that Congress could take to reduce barriers to high-skill immigration. Congress should expand the total number of green cards awarded annually on the basis of worker skills, educational attainment, and economic value, ideally granting green cards to any college graduate who wants to live and work here. Further, Congress should eliminate country-specific caps on high-skill immigration that currently discriminate heavily against immigrants from China and India. In addition, Congress should raise the cap on temporary H-1B visas and reduce the restrictions that limit their use, in particular, the rules that tie visas to a specific employer and prohibit spouses from working here.

Occupational Licensing

Occupational licensing has expanded dramatically in recent decades. Back in 1970, about 10 percent of all U.S. jobs were subject to licensing requirements; today the figure stands at around 30 percent. These laws are justified in the name of consumer protection, but research shows that the laws' restrictions do little or nothing to benefit consumers. They do, however, protect incumbent service providers from competition: licensing is associated with an 18 percent increase in wages for its beneficiaries. In the process, licensing slows down new business formation and job creation: for occupations licensed in some states but not others, employment growth is 20 percent lower in the restrictive states. These laws amount to a frontal assault on entrepreneurship, reducing entry by new businesses that frequently are the vessels of new ideas. Furthermore, by conditioning entry on passing exams that test knowledge of current ways of doing things, they help to cement the status quo in place and discourage the development of new business models.

Most occupational licensing occurs at the state level, but there is still significant scope for Congress to improve matters. For example, Congress could mandate that, for widely licensed occupations, anyone with a valid license in one state would be entitled to do that job in all other states. Alternatively, Congress could preemptively authorize interstate compacts for mutual recognition of licenses. In addition, Congress could follow up on the Supreme Court's decision in *North Carolina State Board of Dental Examiners v. Federal Trade Commission* and clarify that there is no antitrust immunity for actions of licensing boards dominated by private-sector members.

Barriers to Entry

The policy areas discussed above all feature regulations that erect explicit barriers to entry—whether in the economist's sense of barriers to market entry, or in the literal sense of barriers to geographic entry. Copyright and patent laws and occupational licensing limit who can engage in particular kinds of commercial activity; immigration laws limit who can enter the country.

Moreover, all of these entry barriers undermine economic growth by restricting vital inputs to innovation. Copyright and patent protections restrict the recombination of ideas that is the essence of innovation by making some ideas artificially inaccessible. Immigration laws restrict the inflow of highly skilled individuals who are disproportionately entrepreneurial and innovative. Occupational licensing restricts the formation of new businesses, which frequently are the vessels for new products or new production methods.

Finally, all these policy domains have similar distributional consequences: all of them redistribute income and wealth to the well-off and privileged. Copyright and patent laws pinch consumers for the benefit of huge pharmaceutical and media corporations. Immigration laws expose America's lowest-skilled workers to intensifying competition from foreign-born workers while shielding high-skilled workers from equivalent competitive pressures. Occupational licensing boosts the earnings of protected incumbents by restricting supply, especially in higher-income professions, while thwarting upward mobility for the less advantaged.

Beyond Left and Right

In all likelihood due to these underlying similarities, none of these policy areas have become zones of ideological or partisan conflict. To be

sure, there are vigorous debates over proper policy in all of these areas, but the contending sides are not divided along left-right or Republican-Democratic lines. In striking contrast to the polarization and gridlock that now dominate most national policy debates, opposition to regressive regulatory controls has brought together politicians and policy experts across the political spectrum.

Thus, in 2011, in the field of intellectual property, Rep. Nancy Pelosi (D-CA) joined forces with Rep. Darrell Issa (R-CA) and then-Rep. Ron Paul (R-TX) to oppose the Stop Online Piracy Act, a failed legislative effort to toughen criminal penalties for copyright violations. Among policy experts, leading critics of copyright and patent law excesses include progressives Lawrence Lessig and Dean Baker and libertarians Tom W. Bell and Jerry Brito.

With regard to high-skill immigration, a number of bipartisan reform bills have been introduced in recent years. To take a recent example, in January 2015, a group of six senators—including Orrin Hatch (R-UT), Mark Warner (D-VA), and Marco Rubio (R-FL)—introduced the Immigration Innovation Act to boost the numbers of both temporary and permanent visas for highly skilled workers. And among policy experts, scholars from the libertarian Cato Institute and the progressive Center for American Progress supported the most recent comprehensive immigration legislation passed by the Senate in 2013.

As for occupational licensing, the Obama administration issued a special report in July 2015 criticizing occupational licensing, and in 2016, it made a small amount of federal funding available to states that undertake reform. Meanwhile, in July 2014, Rep. Paul Ryan (R-WI) released a widely discussed plan for combating poverty. In the section on regulatory reform, Ryan singled out occupational licensing laws as prime examples of the "regressive regulations" that too often constrict economic opportunity for the least advantaged. Among policy experts, Alan Krueger of Princeton University, who served as chairman of the Council of Economic Advisers under President Barack Obama, is a leading critic of these regulatory restrictions; and the libertarian Institute for Justice has a long track record of challenging and overturning licensing rules in court.

It's not simply the case that one can find policy experts on both sides of the ideological spectrum who support reform of these regressive regulatory policies. More than that, it's difficult to find disinterested policy experts anywhere on the spectrum who support the status quo. Certainly,

there are strong defenders of intellectual property protection, but even in their ranks you will find recognition that current policies are seriously flawed. Thus the economist Carl Shapiro, a prominent supporter of patents generally, has written, "[While] there is no doubt that the patent system taken as a whole plays an important role in spurring innovation, the general consensus is that the U.S. patent system is out of balance and can be substantially improved." In similar fashion, the economist William Fischel, who has written sophisticated defenses of zoning, acknowledges that its exclusionary impact has increased since 1970 and that the "social and economic costs" of contemporary land use regulation are "not trivial." As far as high-skill immigration restrictions, it is difficult to find any scholar who has anything nice to say about the current state of policy.

This combination of qualities—negative impact on entrepreneurship and innovation, absence of political polarization, and an intellectual consensus in favor of reform—makes regressive regulation an especially inviting target for any campaign to enact pro-growth policy reforms. For all who are interested in better long-term U.S. economic performance, this is the low hanging fruit. Reforming these policies is something that we know will make a positive difference, and "we" here refers to the vast bulk of disinterested experts. Yes, it is true that plucking this fruit won't be easy, as the interest groups that benefit from the status quo are politically powerful, well organized, and highly motivated. But knowing what clearly needs to be done, however difficult it might be, is an advantage that should not be underestimated.

Of course, there are many other possible targets for pro-growth policy reforms that Congress could set its sights on. Many big policy battles with important implications for growth are already raging in Washington: the never-ending wrangling over tax policy, resolving the long-term fiscal imbalance, the future of health care reform after the Affordable Care Act, the future of financial regulation after Dodd-Frank. Here, often while pursuing other objectives, policymakers are confronting issues whose resolution will have a significant impact, for better or worse, on the U.S. economy's future prospects. Everyone interested in a brighter growth outlook has a stake in the outcome of these big showdowns.

That said, pursuing an agenda of curbing regressive regulation would allow us to open a new front in the policy fight. Unlike the all-too-familiar policy disputes now ongoing, a campaign against regressive regulation would feature issues new to the national policy spotlight. That is especially

true in the case of occupational licensing, since it occurs largely at the state level and thus is typically ignored by Washington. Meanwhile, the organizing rubric of regressive regulation packages together disparate issues in a novel way and can thereby impart new energy to reform efforts in each of its constituent policy domains.

This new front would look very different from the other, ongoing policy debates. Instead of the opposing forces being arrayed along the left-right axis, here the contest pits an expert consensus across the political spectrum against the interest groups who profit from existing policy. Instead of yet another left-right fight, this time the contest could be framed as a choice between the public interest and vested interests.

The idea of a left-right coalition to push deregulation may sound farfetched, but it is not without precedent. Consider the country's last major episode of pro-market regulatory reform back in the late 1970s and early 1980s. During that brief period of time, price-and-entry regulation of airlines, trucking, and railroads was systematically dismantled; price controls on oil and natural gas were lifted; interest rate caps for checking and savings accounts were removed; and the AT&T monopoly was dismantled, paving the way for competition in long-distance telephony. Those too young to remember can be forgiven for associating all of this with Ronald Reagan, but, in fact, Democrats and progressives played a major role. Jimmy Carter signed the legislation that deregulated airlines, trucking, railroads, and natural gas. On Capitol Hill, Sen. Edward Kennedy (D-MA) led the fight for airline deregulation, ably assisted by his aide Stephen Breyer. Yes, the rise of Chicago-school economics and especially the law-and-economics movement supplied momentum for these sweeping policy changes, but so did the activism of Ralph Nader.

History never repeats itself, but sometimes it rhymes. As in the 1970s, the U.S. economy today is delivering disappointing results. Back then the problem was "stagflation"; today we worry about a "great stagnation." And once again, the shifting currents of political debate are bringing together unlikely allies with a common interest in reviving prosperity and a common hostility to the entrenched interests that stand in the way. With luck, contemporary reformers can follow their predecessors' good example.

Suggested Readings

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—Prepared by Brink Lindsey

8. International Trade and Investment Policy

Congress should

- recognize and publicly acknowledge that the purpose of trade is to increase the size of the economic pie;
- recognize and publicly acknowledge that trade barriers are regressive taxes that reduce real incomes and raise living costs;
- recognize and publicly acknowledge that trade barriers increase the cost of production for businesses in the United States and make them less competitive with producers in other locations;
- recognize and publicly acknowledge that greater access to imports—not greater access to export markets—is the primary conveyor of trade's benefits;
- recognize and publicly acknowledge that production and export subsidies distort markets and benefit the few at a cost to the many;
- recognize and publicly acknowledge that investment in domestic value-added activities is more important to U.S. growth and employment than is reducing foreign market barriers to U.S. exports;
- recognize and publicly acknowledge that "Buy American" provisions in various federal procurement laws and regulations that preclude use of foreign-made products and prohibit bidding from foreign companies result in the waste of tens of billions of dollars of taxpayer resources every year and contribute to budget deficits and the continuous demand for more taxes;

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- eliminate tariffs on imports of intermediate goods—if not on all imported products—to reduce production costs and remove impediments to investment in downstream, import-using, domestic industries;
- reform—if not repeal—the U.S. antidumping law to mitigate the effects of import duties on downstream, import-using, domestic industries;
- pass legislation requiring a comprehensive audit of the U.S. regulatory, tax, and policy environments to identify redundancies, inefficiencies, and systemic problems that artificially raise the cost of doing business and deter investment in U.S. value-added activity;
- reform—if not repeal—the Jones Act to reduce excessively high U.S. transportation costs; and
- ratify the Trans-Pacific Partnership and pursue other forms of trade liberalization.

Why We Trade

Imagine how impoverished we would be if we each lived in isolation, making our own clothes, building our own shelters, hunting and harvesting our own food. Forget leisure or luxuries; all of our time would be consumed trying to produce bare necessities just to subsist. The purpose of exchange is to enable each of us to focus our productive efforts on what we do best. Thus, instead of allocating small portions of our time to the impossible task of producing each of the necessities and luxuries we wish to consume, we each specialize in an occupation and exchange the monetized output we produce most efficiently for the goods and services we produce less efficiently. That way we are able to produce and consume more output than we could in the absence of specialization and trade. The larger the size of the market, the greater is the scope for specialization, exchange, and economic growth.

Free trade is the extension of free markets across political borders. Enlarging markets in this manner—to integrate more buyers, sellers, investors, and workers—enables more refined specialization and economies of scale. Those, in turn, lead to greater wealth and higher living standards. When goods, services, capital, and labor flow freely across borders, Ameri-

cans can take full advantage of the opportunities of the international marketplace.

The benefits of trade come from imports, which deliver more competition, greater variety, lower prices, better quality, and continuing innovation. Opening foreign markets is a valuable part of trade policy because larger markets allow for greater specialization and economies of scale, but real free trade requires liberalization at home. The real benefits of trade are measured by the value of imports that can be purchased with a unit of exports—the so-called "terms of trade." When we transact at the local supermarket, we seek to maximize the value we obtain by getting the most for our dollars. In other words, we want to import more value from the local merchant than we wish to export. In our daily transactions, we seek to run personal trade deficits.

But when it comes to trading across borders or when our individual transactions are aggregated at the national level, we seem to forget these basic principles and assume that the goal of exchange is to achieve a trade surplus. We forget that trade barriers at home raise the costs and reduce the amount of imports that can be purchased with a unit of exports. But, as Adam Smith famously observed, "What is prudence in the conduct of every private family can scarce be folly in that of a great kingdom."

U.S. trade barriers hurt U.S. citizens, as consumers, taxpayers, workers, producers, and investors. Americans would be better off if we simply undertook our own reforms—on tariffs, regulations, and other artificial impediments to commerce—without regard for what other governments do. Congress has the authority to remove U.S. trade barriers, so the fact that many barriers remain implies that policymakers think U.S. citizens are unworthy of the freedom to make their own economic choices. Free trade is about the freedom of people to transact as they wish, when they wish, with whom they wish, and without politicians and bureaucrats as gatekeepers.

Although tariffs and other trade barriers have been reduced considerably since the end of World War II, U.S. policy continues to accommodate egregious amounts of protectionism. We have "Buy American" rules that restrict most government procurement spending to U.S. suppliers, ensuring that taxpayers get the smallest bang for their buck. We have heavily protected services industries, such as air transportation and shipping, that drive up the cost of everything. We have apparently interminable farm subsidies; quotas and high tariffs on imported sugar; and high tariffs on basic consumer products, such as clothing and footwear. We have energy

export restrictions, the market-distorting cronyism of the Export-Import bank, and antidumping duties that strangle downstream industries and tax consumers. We have regulatory protectionism masquerading as public health and safety precautions, protectionist rules of origin and local content requirements that limit trade's benefits, and restrictions on foreign investment. The list goes on.

Interdependence

In our globalized economy, expanding the size of the market not only means more customers, it means more competition for U.S. consumers' dollars, more providers of intermediate goods, more opportunities for supply chain collaboration, greater variety, innovation, and so on. When trade barriers come down, the factory floor can span borders and oceans, and production can be organized in new and more efficient formats. The result is more value creation and greater wealth.

Globalization means that companies have growing options with respect to where and how they produce. So governments must compete for investment and talent, which both tend to flow to jurisdictions where the rule of law is clear; where there is greater certainty to the business and political climate; where the specter of asset expropriation is negligible; where physical and administrative infrastructure is in good shape; where the local workforce is productive; where there are limited physical, political, and administrative frictions; and so on.

In most tradable industries, global production sharing has become the norm. In 2015, about half of the value of U.S. imports was industrial supplies, other intermediate goods, and capital equipment—the purchases of U.S. businesses, not end-user consumers. According to estimates from the World Trade Organization and the Organization for Economic Cooperation and Development, over two-thirds of the value of global trade flows in 2015 was intermediate goods trade.

Increasing global interdependence is reflected in a variety of other statistics, as well. For example, only about 50 percent of the value of U.S. imports from China reflects Chinese labor, materials, and overhead. The other half consists of value added in other countries. When it comes to high-technology products, Chinese value added is much lower—less than 5 percent for the "Assembled in China" Apple iPhone.

Meanwhile, more than 30 percent of the content value of a Boeing Dreamliner is imported or produced by foreign-owned companies in the United States. The largest steel producer in America is Arcelor-Mittal,

a majority Indian-owned company with headquarters in Luxembourg. American icon General Motors produces and sells more automobiles in China than in the United States; Ford Motor Company has more production and assembly operations outside the United States than within it; Chrysler is an Italian company; and more than half of U.S. auto production occurs in foreign nameplate factories across the United States. In fact, there is over $1 trillion of foreign direct investment in U.S. manufacturing operations—the most foreign investment in any country's manufacturing sector—and more than 6 million Americans work for foreign-headquartered companies in the United States.

Exposing and Refuting the Myths Surrounding Trade

Electoral campaigns are often rife with misinformation about trade, free trade, free trade agreements, and U.S. trade policy. Members of Congress should feel a responsibility to distill fact from fiction and to set the record straight for the American public. A rejection of trade and international cooperation in favor of protectionism and retrenchment would be a costly mistake—as history reminds us. Members of Congress should be aware of the most common trade fallacies and be able to refute them.

Trade Is Not a Zero-Sum Game

Too often trade is portrayed as a competition between Team USA and the foreign team. According to that narrative, exports are Team USA's points; imports are the foreign team's points; the trade account is the scoreboard; the deficit appearing on that scoreboard means the United States is losing at trade; and it's losing because the foreign team cheats.

But trade does not lend itself to sports metaphors. It is not a zero-sum game with a winning and losing team. Trade is a mutually beneficial endeavor that occurs between people—not countries—seeking to obtain value. Aggregated trade statistics are just the culmination of billions of daily transactions between people cooperatively pursuing the satisfaction of their needs and wants.

The Trade Deficit Does Not Reflect Trade Policy Failure

The objective of trade policy is not to secure a trade surplus, but to create the conditions that enable individuals to specialize in the most refined capacities, create greater value, exchange larger surpluses, and

achieve stronger economic growth. Those are the mechanisms through which the wealth of nations expands.

The United States has run trade deficits for 41 straight years and, as the issuer of the world's preferred reserve currency, may always run trade deficits. Those deficits reflect favorable global perceptions of the quality of U.S. investments. There is no leakage of economic activity associated with running trade deficits because the excess dollars that go abroad to purchase more from foreigners than foreigners purchase from Americans comes back to the United States in the form of investment. That investment undergirds U.S. economic activity, which supports jobs.

The data strongly suggest that there are positive correlations between the magnitude and direction of the trade deficit and the magnitude and direction of economic output. The same goes for the relationship between the trade deficit and U.S. employment. Looked at another way, if the goal of trade policy is to achieve a trade surplus, then by extension the goal of trade policy is slower economic growth, even contraction.

U.S. Manufacturing Is Thriving in the Global Economy

One of the most persistent fallacies is that international trade killed U.S. manufacturing. The problem with the assertion is that U.S. manufacturing is thriving—as it always has. By any relevant measure—output, value added, revenues, exports, imports, investment, research and development expenditures—U.S. manufacturing remains a global "powerhouse." With respect to most of those metrics, year after year (except during recessions), the sector sets new records.

Manufacturing's share of the U.S. economy peaked in 1953 at 28.1 percent; today, manufacturing accounts for only 12.1 percent of gross domestic product (GDP). But in 1953, U.S. manufacturing value added amounted to $110 billion, compared with a record $2.1 trillion in 2015. A sector that produces, today, more than six times the value in real terms what it produced when it was the engine of the U.S. economy, can hardly be described as declining.

Of course, employment in the manufacturing sector peaked at 19.4 million workers in 1979 and has been on a downward trajectory ever since. But that is something to celebrate, not lament. Producing more output with fewer inputs is the objective of economic activity. These so-called "productivity gains" are the wellspring of wealth creation and higher living standards. It is a sign of manufacturing strength, not weakness, that fewer workers are required on the production line today. If 10 workers

were needed to produce 1,000 widgets per day last year, but use of a new machine enabled 5 workers to produce the same number of widgets per day this year, then that productivity improvement amounted to a doubling of output per worker. Still, to reap the full benefits of that productivity gain, the talents of the 5 displaced workers must be redeployed elsewhere in the economy. Thus, it is incumbent upon policymakers to remove the impediments to labor market adjustment that slow or prevent displaced workers from finding new jobs in new firms in new industries.

U.S. manufacturing attracts more foreign direct investment than any other country's manufacturing sector. After 12 straight years of net growth, the stock of foreign direct investment in U.S. manufacturing surpassed $1 trillion in 2014. By comparison, the stock of foreign direct investment in China's manufacturing sector—the world's second largest manufacturing investment destination, which is now famously rife with overcapacity—is less than half that of the U.S. stock.

Outsourcing Is Good for the U.S. Economy

People tend to think of outsourcing, or outward foreign direct investment, as a substitute to domestic value-added activity. The quintessential example is that of a factory closing somewhere in the Rust Belt and being rebuilt in Mexico or China, rafter by rafter, bolt by bolt to produce for export back to the United States. U.S. companies invest abroad for a variety of important reasons, but serving U.S. demand from those foreign locations is not prominent among them. Over 90 percent of the value of output from foreign affiliates of U.S.-based companies is sold in foreign markets.

Most outward investment is made to serve purposes that cannot be fulfilled practicably or cost-effectively in the United States. Reaching potential foreign customers without having any physical presence in their countries, for example, would be a difficult task. There are several reasons to invest abroad that are highly unlikely to be successfully replicated from within the United States. They include marketing to foreign customers, getting better acquainted with foreign product preferences, having retail locations to serve demand abroad, performing postsale and other customer-service activities, tapping into local expertise, and diversifying market-specific risks.

Outward investment is essential for U.S.-based companies to compete effectively in the global economy. In reality, outsourcing is overwhelmingly complementary to U.S. value-added activity, not a substitute for it.

Small and Medium-Sized Businesses and Lower-Income Americans Are the Primary Beneficiaries of Trade.

The myth that trade disproportionately benefits big multinational corporations and high-income individuals is another assertion that fails to hold up to the evidence. Trade barriers increase the costs of goods and services to businesses and the cost of living for consumers. Trade barriers are costs. A tariff or other barrier to trade is much more likely to deter a small or medium-sized firm than a large sophisticated firm from engaging in international trade. Likewise, the cost of a tariff constitutes a much higher percentage of a lower-income family's budget than a higher-income family's budget. It is a regressive tax.

The Gilded Age adage that "the tariff is the mother of the trust" is still quite apt today. Protectionism always has and always will serve to protect incumbent business interests from competition.

Recommendations for Congressional Action

Eliminate Tariffs on All Intermediate Goods

At great expense to producers, consumers, and taxpayers, the U.S. government maintains "protective" tariffs on thousands of imported products, including many items not even produced domestically. To mitigate those costs, Congress has, on occasion, suspended the duties on some of these products through the passage of so-called "miscellaneous tariff bills." These bills temporarily suspend duties on certain, noncontroversial products—usually intermediate goods, such as chemicals, electronic components, and mechanical parts—that are not manufactured domestically but that U.S. producers need to generate their own output. The impact of these bills is limited by their temporary nature, by the requirement that there be "no domestic production," and by the caveat that the suspended duty must not reduce tariff revenues by more than $500,000.

The last miscellaneous tariff bill provided an estimated $748 million of import tax relief. However, in 2014, U.S. Customs collected nearly $45 billion in duties, taxes, and fees levied on imports, with approximately $27 billion collected on imported intermediate goods. That amounts to nothing more than a tax on U.S. value creators.

Recognizing that downstream import-consuming industries account for a greater share of U.S. GDP, employ more workers, pay more taxes, and are more innovative than the protected firms in upstream industries that produce raw materials, Congress should permanently eliminate import

duties on all intermediate goods, regardless of the existence of domestic production. Otherwise, Congress should expect duties on products like sugar, steel, magnesium, polyvinyl chloride, and other crucial manufacturing inputs to continue to chase companies to foreign shores—where those inputs are less expensive—and deter foreign companies from setting up shop stateside.

Reform the Antidumping Law to Mitigate Collateral Damage on U.S. Import-Consuming Firms

Antidumping proceedings involve more than a dispute between a domestic industry and its foreign competition. They also involve a conflict of interests between the relief-seeking U.S. industry and its U.S. customers. Those U.S. customers—usually other producers—are given no quarter under the law. If the petitioning industry can demonstrate that it has suffered "material injury" on account of less than fair value imports, duties are imposed—regardless of the impact on the downstream-consuming industries and the economy at large.

That is hardly a recipe for rational policymaking. Antidumping duties on products such as magnesium, saccharine, polyvinyl chloride, and hot-rolled steel may please their domestic producers, who are freed to raise prices and reap larger profits. But those same duties are costly to U.S. producers of auto parts, food products, paint, and appliances, who consume those products as inputs in their own manufacturing processes.

Since 2000, close to 90 percent of all U.S. antidumping measures involved imposing duties on imported intermediate goods. Yet the statute forbids the administering authority from considering the economic impact of antidumping restrictions on those downstream, import-consuming firms or on the economy at large. The antidumping law should be changed to give producers in consuming industries legal standing to participate meaningfully in antidumping proceedings; to require the administering authorities to conduct an analysis of the economic impact of prospective antidumping duties on downstream industries and the economy at large; and to deny imposition of duties if the estimated costs exceed a certain threshold.

Require an Audit of U.S. Regulatory, Tax, and Policy Environments

In the global competition to attract investment from the world's best companies, the United States has some enormous advantages. For many decades, the United States has been the world's premier destination for

foreign direct investment. But in recent years, the United States has been slipping in a number of important investment-location decision criteria. Accordingly, its share of global foreign direct investment declined from 39 percent in 1999 to 21 percent in 2015.

Congress should formally recognize that the United States is competing with the rest of the world to attract investment in domestic value-added economic activities, and that success in that regard requires maintenance of smart domestic policies. Accordingly, Congress should pass legislation requiring a comprehensive audit of the U.S. regulatory, tax, and policy environments to identify redundancies, inefficiencies, and systemic problems that artificially raise the cost of doing business and deter investment in U.S. value-added activity.

Foreign direct investment is a verdict about the efficacy of a country's institutions, policies, and potential. Given the importance of foreign direct investment to economic growth, understanding its determinants and crafting policy accordingly are matters of good governance and common sense. As Sen. Bob Corker (R-TN) put it, "If we want the U.S. to be the very best place in the world to do business, we need to take a close look at what we're doing right, what we're doing wrong, and how we can eliminate barriers that diminish investment in the U.S."

Repeal the Jones Act

Congress should finally repeal the nearly 100-year-old Jones Act, which has been a spectacular failure. It has resulted in the near total decimation of the U.S. shipbuilding industry and increases in the costs of shipping, infrastructure projects, and other forms of transportation—all of which have raised the costs of production and retail prices in the United States for the benefit of a few protected interests. Among the act's unjustifiable provisions is a ban on foreign shipping between U.S. ports, which is estimated to raise the costs of shipping by $2.8 billion (1996 dollars) annually, according to an International Trade Commission report. However, the indirect costs of using less-efficient transportation modes and routes (highway and rail)—including traffic delays, infrastructure erosion, environmental degradation, and higher costs of federal and state procurement projects—adversely affect U.S. GDP as well. Removing Jones Act restrictions to permit greater competition in maritime shipping (as well as air and rail transport) would reduce costs and prices, increase efficiencies, and help the United States remain competitive as a destination for investment.

Ratify the Trans-Pacific Partnership

The Trans-Pacific Partnership (TPP) is a comprehensive trade and investment agreement between the United States and 11 other Pacific-Rim nations, which reduces tariffs and other impediments to trade and investment. Its value as an agreement to create greater wealth and higher living standards by more closely integrating 12 economies accounting for 40 percent of global GDP is indisputable. But there is an even bigger picture to consider.

The TPP is the first step in the process of reestablishing the primacy of nondiscrimination and other tenets of the U.S.-led, post-WWII liberal economic order. It is a blueprint for securing U.S. geoeconomic and geopolitical interests now and into the future by refreshing the rules of international trade law and accommodating those institutions to a multipolar, 21st-century global economy.

Work with the President to Ensure that Other Trade-Liberalizing Initiatives Are Pursued

Other trade initiatives worthy of continued pursuit include the Transatlantic Trade and Investment Partnership, the World Trade Organization's Trade in Services Agreement, and the U.S.-China Bilateral Investment Treaty.

Although progress in the Transatlantic Trade and Investment Partnership negotiations has been slowed by a variety of factors (including the United Kingdom's likely departure from the European Union), the objective of removing trade barriers between the United States and Europe, as envisaged by the negotiations thus far, would likely yield large dividends for the U.S. economy. Likewise, the negotiations in the World Trade Organization to reach an agreement on services liberalization, if successful, would reduce impediments to competition from foreign service providers in the U.S. market, while creating greater opportunities for U.S. services firms to compete abroad. Finally, the ongoing negotiations with China over a bilateral investment treaty could very well reach a conclusion in the coming year, opening new sectors of the Chinese economy to U.S. investment and vice versa. However, the process could take longer. Either way, congressional support for an eventual investment treaty with China would demonstrate commitment to broadening economic opportunities for Americans, as well as interest in keeping the bilateral relationship on solid ground.

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—Prepared by Daniel Ikenson

9. Dealing with ISIS in Iraq and Syria

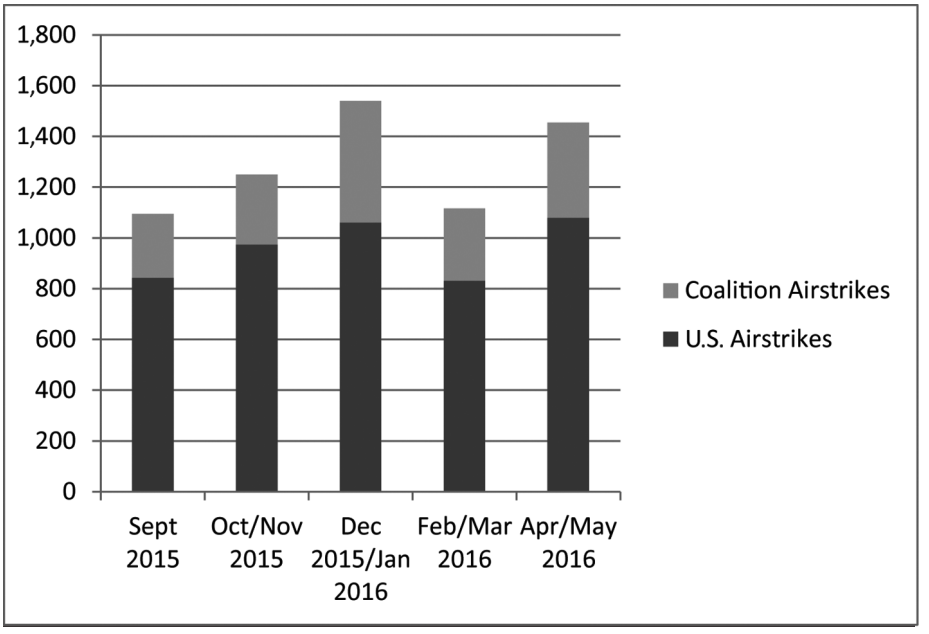
Policymakers should

- understand that ISIS does not pose an existential threat to the United States;
- accept that U.S. military intervention in Syria and Iraq is unlikely to create a stable postconflict environment;
- avoid escalation of the current military campaign against ISIS;
- seek instead to contain the group with air power, while encouraging local and regional partners to roll back the group on the ground; and
- actively pursue a negotiated political transition to end Syria's civil war.

Since August 2014, the United States and a coalition of more than 60 countries have been engaged in an open-ended military campaign against the (self-proclaimed) Islamic State (ISIS) inside Iraq and Syria. Yet, as Figure 9.1 illustrates, the United States has borne the brunt of this effort. (In 2015 and 2016, the United States launched over 12,000 airstrikes, at a cost of more than $9.3 billion to U.S. taxpayers.) In addition, as of July 2016, the United States had at least 5,000 troops on the ground in Iraq and a smaller number of special operations forces in Syria, coordinating airstrikes and training Iraqi government and Syrian rebel forces to fight ISIS more effectively.

Progress against ISIS has been slow but steady. The group has lost a substantial amount of territory—including the key city of Ramadi in Iraq; and while it was initially able to bring in enough recruits to offset losses from the air campaign, recruitment has dropped in 2016, denying the group much-needed fighters. Nonetheless, ISIS's use of innocent civilians

Figure 9.1
Recent U.S. and Coalition Airstrikes against ISIS



SOURCE: All data from U.S. Department of Defense, Operation Inherent Resolve website: http://www.defense.gov/News/Special-Reports/0814_Inherent-Resolve.

as human shields has constrained the U.S. air campaign, and gains on the ground by U.S. coalition partners have been limited. Kurdish forces remain the only truly effective ground force in Syria. Iraqi forces have made slow but steady progress since the army's humiliating 2014 defeat by ISIS, retaking several key towns, but much of that progress can be attributed to independent sectarian militias rather than official government forces, a factor that will substantially complicate postconflict stabilization. Meanwhile, attacks in Paris, Brussels, and Orlando make clear that even as it is losing at home, ISIS can inspire terrorist attacks well outside its own self-proclaimed caliphate.

Yet, ISIS itself does not pose a major threat to the United States. As a proto-state, the group is unable to carry out any form of conventional military attack against the United States. And as with all terrorist groups, ISIS's ability to hurt Americans is small. There is a key difference between ISIS and other groups like al Qaeda: the latter planned and coordinated its attacks centrally; but many of the Western attacks attributed to ISIS—including mass shootings in San Bernardino, California, in December

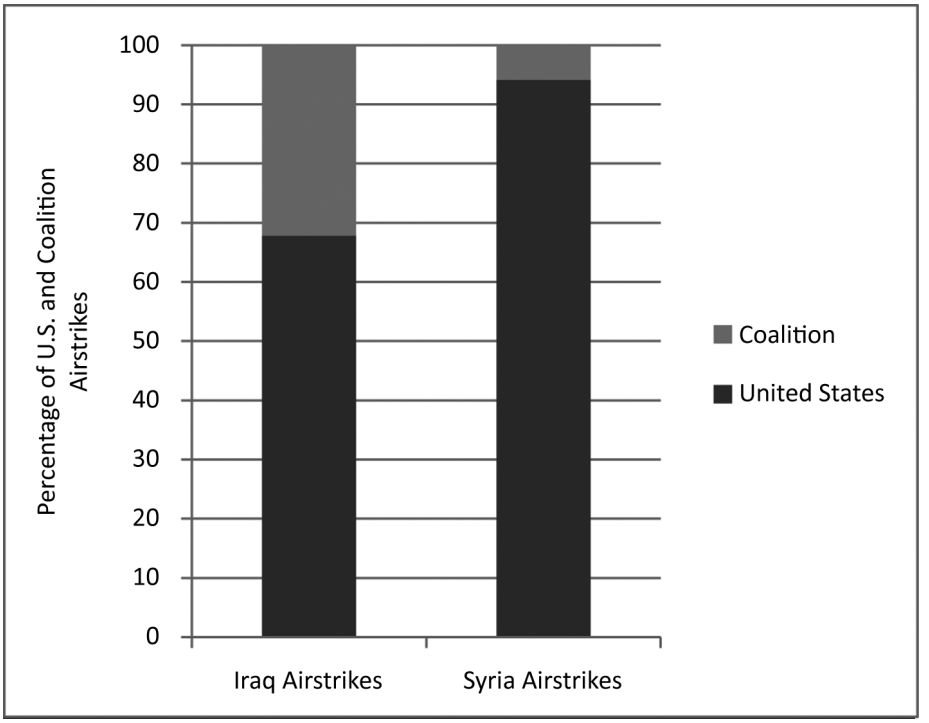
2015, and Orlando, Florida, in June 2016—can best be described as inspired by ISIS, rather than directed by it. In both those cases, the perpetrators had no prior links with ISIS and had not been in contact with the group prior to their attacks.

Attacks directed or planned by ISIS itself remain unlikely inside the United States, which is less vulnerable to infiltration from abroad than many European nations. The sudden mushrooming of ISIS affiliates around the globe in 2015 and 2016 is likewise not as threatening as it might seem. In fact, most of those groups already existed as local or regional terrorist groups. For example, the ISIS affiliate credited with bringing down a Russian airliner in Egypt began life as the separatist group Province of Sinai; and Nigeria's Boko Haram was active more than a decade before the rise of ISIS. Most of the groups that have sworn allegiance to ISIS have limited, local aims.

Nonetheless, there are other strategic concerns: though ISIS poses only a limited risk to the United States, it could threaten the stability of various Middle Eastern states. In addition to its role in violent insurgencies in Iraq, Syria, and Libya, ISIS has claimed responsibility for bombings and attacks throughout the Middle East, including targeting tourists in Tunisia and Egypt, and bombing airports, mosques, and other public areas in Yemen, Saudi Arabia, Turkey, Egypt, and Lebanon. Though not solely attributable to ISIS, the Syrian civil war has created the worst refugee crisis since World War II, and while much of the attention has focused on Europe, most refugees are fleeing to nearby countries. The resources of many of the region's poorest countries are being stretched by this influx: 20 percent of Lebanon's current population is Syrian refugees.

Given the predominantly local threat of ISIS, it is perhaps surprising how little effort regional states have so far committed to the fight against it. As Figure 9.2 illustrates, the disparity between U.S. airstrikes and coalition airstrikes—carried out by several North Atlantic Treaty Organization (NATO) member states as well as local states such as Saudi Arabia, Qatar, and Jordan—is even starker in Syria than in Iraq. Progress in Syria has been impeded by some states' insistence on the removal of Syria's Bashar al-Assad, which would likely only empower ISIS in the near term. Indeed, many of America's partners, including Saudi Arabia, Turkey, and Qatar, were heavily involved in funding and arming anti-Assad rebels inside Syria and have proved reluctant to shift their focus to ISIS. Turkey's long-running conflict with its own Kurdish minority has further undermined the anti-ISIS campaign, as the Erdogan government has chosen to bomb ISIS and various Kurdish groups inside Syria simultaneously.

Figure 9.2
U.S. vs. Coalition Commitments in Iraq and Syria (2014–2016)



SOURCE: All data from U.S. Department of Defense, Operation Inherent Resolve website: http://www.defense.gov/News/Special-Reports/0814_Inherent-Resolve.

Some have suggested that regional states' apathy should be offset by increased American military involvement in Syria and Iraq. But even if we ignore the fact that that is not a proportional response to the limited threat ISIS poses to the United States, it is also no substitute for the involvement of local and regional actors in the fight. The lessons of the 2003 invasion of Iraq and the 2011 Libya intervention are clear: the United States can achieve military victory with ease, but creating lasting stability is far more difficult—and impossible without the cooperation of local and regional actors.

In the case of ISIS, the U.S. military could undoubtedly defeat the group with a large conventional ground force, though it would be costly. However, the withdrawal of U.S. forces afterward would leave a vacuum, offering the prospect of a resurgent ISIS or of similar groups rising to take its place. To avoid such chaos, postconflict stabilization would require

a potentially decades-long peacekeeping operation. Recent experiences in Iraq and Afghanistan, however, have confirmed that long-term nation-building missions are likely to fail. They are deeply unpopular among the Americans who will be paying the costs and are resented by local actors who object to outsiders meddling in their political affairs.

Similar problems plague many of the proposed solutions to the Syrian problem. No-fly zones, including so-called "no bombing zones," or "humanitarian zones," may seem relatively costless and valuable humanitarian acts. But in practice, they require a substantial commitment of both air and ground forces to maintain. In Syria, the creation of such zones would bring U.S. forces into direct military confrontation with the Assad regime and its Russian backers. Related proposals—such as committing many more special operations forces inside Syria—have comparable problems. All these options are prone to "mission creep."

Ultimately, a policy similar to the Obama administration's initial strategy—containing ISIS with airpower, while encouraging local and regional partners to roll back the group on the ground—remains the best approach. The United States should also push other coalition members to contribute more to the air campaign. After all, many of those countries are more threatened by ISIS than the United States itself; shifting at least some of the responsibility for military action against ISIS to those states would produce a more durable campaign and spread the burden of such action more evenly and effectively. And while the military campaign does have the potential to undermine the growth of ISIS inside Iraq and Syria, policymakers must be aware that no military campaign can prevent homegrown or lone wolf–style attacks inspired by ISIS. Dealing with that threat remains the job of the intelligence and law enforcement communities, not the military.

The prerequisite to successfully undermining ISIS is a coherent political solution, involving regional and local players, in both Syria and Iraq. Of course, even if regional players are involved, chaos may still result in Syria. States such as Iran, Saudi Arabia, and Qatar have already worsened the situation in Syria, but their existing ties to the conflict mean that little can be achieved without their continued involvement. The same applies to other parties to the Syrian conflict, including Russia, the United States, moderate Syrian rebel groups, Kurdish factions, and even the remnants of the Assad regime. Multilateral coordination between all the stakeholders—not just on fighting ISIS but on the political negotiations that will determine Syria's future—will improve the prospect of eventual

stability. ISIS is widely despised, and though historical enmity, regional rivalries, and distrust all impede effective cooperation between these parties, the Syrian civil war and Iraq's political turmoil are the bigger obstacles.

The United States can do little to improve the political situation in Iraq other than encourage much-needed reforms, particularly on issues of corruption and sectarianism. The United States can provide diplomatic support, but these are challenges the government of Haider al-Abadi must overcome alone. In contrast, there are several possible diplomatic paths to ending the Syrian civil war, grounded in the United Nations' Geneva process, which seeks to create a new governing structure for Syria. With strong U.S. support and initiative on the diplomatic front, a successful transition is possible in Syria. Certainly, it will be difficult to overcome the differences between the states that support the Assad regime and those that oppose it. A deal will likely require unpleasant compromises, such as a lengthy transition period that initially leaves Assad in power. And implementation will rest on the ability of external actors—chiefly the Saudis, Russians, Iranians, Turks, and Qataris—to force their proxies within Syria to comply, which is no simple feat. But the basic shape of a deal that once seemed unthinkable has already been hammered out in negotiations, and the agreement on cessation of hostilities in March 2015 implies that such a deal could be achieved.

Another option that could emerge from Geneva is some form of federalism, or even de facto partition of Syria, creating an Alawite rump state around Damascus, a Kurdish region in the country's north, and a Sunni-majority zone elsewhere. Even without an overarching peace settlement, partition would lower the overall levels of violence and refugee flows and would create time to conduct broader negotiations on the future of the Syrian state. That outcome may be easier to achieve than a full peace deal or federalism, but partition will not give all parties inside Syria a stake in seeing ISIS destroyed: the Assad regime, far from ISIS-controlled territory, would probably prefer to sit out the fight, hoping that ISIS weakens other groups enough for the regime to regain territory. Thus, a negotiated transition remains the best option for Syria.

Ultimately, all roads to decisively defeating ISIS in Iraq and Syria begin with a solution to Syria's appallingly violent civil war. In addition to the current U.S. role in containing ISIS militarily, U.S. policymakers should focus their efforts on diplomacy and on building the Syrian domestic and regional support necessary to replace ISIS in the long term. This level of involvement is greater than required for U.S. security, given the minimal

risk that ISIS poses to Americans. But our involvement is warranted in the interest of resolving a deeply destabilizing conflict, one that the United States is at least partly responsible for starting. Policymakers should refrain from increasing U.S. military intervention—whether in the form of troops on the ground, humanitarian safe zones, or no-fly zones—as such involvement has substantial risks.

The limited military action proposed here will not produce results overnight. Nor can any military approach truly eradicate a terrorist group like ISIS. But this restrained approach is far more likely than other approaches to destroy the group's foothold in Iraq and Syria, while ensuring a stable postconflict environment.

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—Prepared by Emma Ashford

10. Relations with Cuba

Policymakers should

- repeal the Cuban Liberty and Democratic Solidarity (Libertad, or Helms-Burton) Act of 1996;
- repeal the Cuban Democracy (Torricelli) Act of 1992;
- restore the policy of granting Cuban refugees political asylum in the United States;
- eliminate or privatize Radio and TV Marti; and
- end all remaining sanctions that prevent U.S. companies from trading and investing in Cuba.

On December 17, 2014, President Barack Obama announced that Washington would seek to restore diplomatic relations with Cuba after more than half a century of antagonism—an animosity that lingered for decades even after the fall of the Berlin Wall and the end of the Cold War. His administration had signaled early on its willingness to engage the island, but few expected such a dramatic shift in such a short period of time: nine months after the announcement, the U.S. flag was flying again outside the reopened U.S. embassy in Havana, and in March 2016, Obama became the first sitting U.S. president to visit Cuba since 1928.

Rapprochement was long overdue given the blatant failure of the previous U.S. policy in bringing about democracy in Cuba through economic sanctions and diplomatic isolation. Polls also showed widespread support for normalization: ahead of President Obama's historic trip, 58 percent of Americans said they favored the diplomatic thaw. Even a majority of Cuban-Americans expressed in different surveys their opposition to continuing the embargo. More significantly, 97 percent of Cubans on the island—the people who are supposedly the ultimate beneficiaries of U.S. policy—support normalization, according to an April 2015 *Washington Post* poll.

Beyond restoring diplomatic ties, in the last two years, many things have changed in the relationship between the United States and Cuba: dozens of commercial flights per day have been authorized, as well as cruise ships and ferries; Americans are allowed to travel practically without constraints to the once-forbidden island, and hundreds of thousands are doing so every year; U.S. tourists can now use their credit and debit cards in Cuba; limits on remittances have been lifted, and the money can now be directed to the development of private businesses; U.S. citizens are permitted to trade with authorized independent Cuban businesspeople; and U.S. telecommunication firms are also allowed to sell services to the island. Exercising its executive authority, the Obama administration went as far as it could in relaxing many economic sanctions. However, U.S. companies are still prevented from most commerce and investment in Cuba. Lifting those outstanding prohibitions is a prerogative of Congress.

The death of Fidel Castro in November 2016 is yet another recent change in Cuba. However, it is unlikely to change the nature of the authoritarian regime or weaken its grip on the country, at least in the short term, as it has been preparing for a post-Fidel Cuba for years. By the same token, Castro's death should not alter the direction of U.S.-Cuban relations.

Leaving the Cold War in the Past

Sanctions against Cuba were first authorized under the Foreign Assistance Act of 1961, passed by the 87th Congress. In 1962, President John F. Kennedy issued an executive order implementing the trade embargo. The move was a response to Fidel Castro's expropriation of American assets and his decision to offer the Soviet Union a permanent military base and an intelligence post just 90 miles off the coast of Florida at the height of the Cold War. Castro's decision confirmed Cuba as the Soviet Union's main ally in the Western Hemisphere.

For three decades, Cuba was a threat to U.S. national security. Not only did Cuba export Marxist-Leninist revolutions to Third World countries (most notably, Angola and Nicaragua), but more important, it also served as a base for Soviet intelligence operations and allowed Soviet naval vessels port access rights. However, with the collapse of the Soviet Union and the subsequent end of Soviet subsidies to Cuba in the early 1990s, that threat virtually ceased to exist. Trade sanctions against Cuba, however, were not lifted. The embargo was instead tightened in 1992 with the passage of the Cuban Democracy ("Torricelli") Act.

The justification for that act was not national security interests but the Castro regime's form of government and human rights abuses. That change of focus was reflected in the language of the act, the first finding of which was Castro's "consistent disregard for internationally accepted standards of human rights and for democratic values." In 1996, Congress passed the Cuban Liberty and Democratic Solidarity ("Libertad") Act, a bill that President Clinton had threatened to veto but instead signed into law in the aftermath of the downing of two U.S. civilian planes by Cuban fighter jets in international airspace.

Unintended Consequences of a Flawed Policy

The Libertad Act—better known as the Helms-Burton Act for its sponsors Sen. Jesse Helms (R-NC) and Rep. Dan Burton (R-IN)—is ill conceived. It grants U.S. citizens whose property was expropriated by Castro the right to sue in U.S. courts foreign companies and citizens "trafficking" in that property (Title III). That right—not granted to U.S. citizens who may have lost property in other countries—is problematic because it essentially extends U.S. jurisdiction to the results of events that occurred in foreign territory.

By imposing sanctions on foreign companies profiting from property confiscated by the Castro regime, the Helms-Burton Act seeks to discourage investment in Cuba. However, while Helms-Burton may have slowed investment in the island, U.S. allies (in particular Canada, Mexico, and members of the European Union) have never welcomed that attempt to influence their foreign policy by threat of U.S. sanctions.

In May 1998, the Clinton administration and the European Union (EU) reached an agreement that excludes citizens of EU countries from Titles III and IV (denying entry visas to the executives of companies "trafficking" in confiscated property) of the Helms-Burton Act in exchange for guarantees from the EU not to subsidize investments in expropriated properties. The Bush and Obama administrations continued the policy of repeatedly waiving Title III of the act. But only Congress can repeal both titles.

Moreover, the economic sanctions continue to be the best excuse that the communist regime has for its failed policies. Cuban officials have estimated the cumulative cost of the embargo at more than $116.8 billion. They incessantly condemn U.S. policies for causing the meager existence of their people, even though Cuba accepted more than $100 billion in subsidies and credits from the Soviet Union during their three-decade

relationship and in recent years received up to 20 percent of its annual gross domestic product in the form of subsidized oil from Venezuela. Elizardo Sánchez Santa Cruz, a leading dissident, has aptly summed up that strategy: "[Castro] wants to continue exaggerating the image of the external enemy which has been vital for the Cuban Government during decades, an external enemy which can be blamed for the failure of the totalitarian model implanted here." Cuban dissident blogger Yoani Sánchez called the embargo "the regime's excuse for all its failures" and pointed out that its existence has undermined the work of dissidents on the island.

Ironically, the economic sanctions became somewhat of a U.S. security liability. A 2007 report by the Government Accountability Office pointed out that enforcing the embargo and travel ban diverted limited resources from homeland security that could be used to keep terrorists and criminals out of the United States. The report warned that arrival inspections from Cuba intended to enforce the embargo were "straining Customs and Border Patrol's capacity to inspect other travelers according to its mission of keeping terrorists, criminals, and inadmissible aliens out of the country."

New Cuba Policy Based on American Principles

Washington's policies toward Cuba should be consistent with traditional American principles. First, the United States should restore the practice of granting political asylum to Cuban refugees. The 1994 and 1995 immigration accords between the Clinton administration and the Cuban government have turned the United States into Havana's de jure partner in oppressing those Cubans who risk their lives to escape repression. The "wet feet, dry feet" policy, which grants political asylum to Cuban refugees who make it to the U.S. shore on their own and forces the U.S. Coast Guard to return to Cuba those refugees that it picks up at sea, should be eliminated. Instead, the U.S. government should grant political asylum to all Cubans who escape the island.

There is no reason to believe that Cuban refugees would not continue to help the U.S. economy as they always have. The 1980 boatlift, in which 120,000 Cuban refugees reached U.S. shores, proved a boon to the economy of southern Florida. In addition, since the Cuban-American community has repeatedly demonstrated its ability and desire to provide for refugees until they can provide for themselves, such a policy need not cost U.S. taxpayers.

Second, the U.S. government should protect its own citizens' inalienable rights and recognize that free trade is itself a human right. As James Dorn of the Cato Institute says, "The supposed dichotomy between the right to trade and human rights is a false one. . . . As moral agents, individuals necessarily claim the rights to liberty and property in order to live fully and to pursue their interests in a responsible manner." In the case of Cuba, U.S. citizens and companies should be allowed to decide for themselves—as they do in the case of dozens of countries around the world whose political and human rights records are less than admirable—whether and how they should pursue trade there.

Third, U.S. policy toward Cuba should focus on national security interests, not on transforming Cuban society or micromanaging the affairs of a transitional government, as current law obliges Washington to do. That means lifting the remaining economic sanctions. Those measures will ensure a more peaceful and smooth transition in Cuba.

Fourth, Cuban exiles should be allowed to participate in the transformation of Cuban society. However, their participation need not require the U.S. government's active involvement. Thus, Radio and TV Marti, government entities that broadcast to Cuba, should be privatized or closed down. If the exile community believes that those stations are a useful resource in its struggle against the Castro regime, it has the means—there are no legal impediments—to finance such an operation.

Conclusion

Despite all the changes in the bilateral relationship, one thing remains constant: the repressive nature of Cuba's regime. The Communist Party maintains its firm grip on power. Dissidents are constantly harassed, and arbitrary detentions of peaceful opposition activists have actually increased since normalization. The much-heralded economic reforms launched after Raúl Castro came to power in 2006 are moving at a glacial pace. Approximately 20 percent of Cubans already work in the private sector, but the constraints imposed by the government on local businesses through high taxes and stifling regulations suggest that the regime is interested in doing as little reform as possible to keep the economy afloat while maintaining strict control over the population. If there is a lot of enthusiasm about Cuba lately, it has to do more with what Washington is doing than what Havana is actually delivering.

However, this should not be seen as an indictment of the Obama administration's rapprochement: Washington's previous policy of isolating

the island was utterly counterproductive. In recent years, with the ascendancy of left-wing governments in Latin America, and with U.S. influence dwindling in the region, Cuba saw its influence rise. The island even hosted all of Latin America's heads of state in a summit in 2013—the resulting declaration cynically called for strengthening democracy and human rights in the region. The U.S. approach toward Cuba failed to bring about democracy on the island and instead provided Havana with an excuse to portray itself as the victim of U.S. aggression; the Obama administration did right by shifting course.

The future of freedom in Cuba depends ultimately on Cubans themselves. Unfortunately, Cuba's prospects will be limited as long as it retains its failed communist system. But through engagement, Washington may be able to nudge developments on the island, such as the rate of business formation and the spread of ideas through higher interaction between American tourists and locals. That is why Congress should pick up where President Obama left off and move to fully end the remaining sanctions on Cuba.

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—Prepared by Juan Carlos Hidalgo and Ian Vásquez

11. Reforming Surveillance Authorities

Congress should

- reform Section 702 of the FISA Amendment Act to close its "backdoor search" and "about search" loopholes;
- update the Electronic Communications Privacy Act to provide meaningful protection for stored communications and location data;
- protect the integrity of strong encryption technologies against proposals to create government backdoors; and
- develop a statutory framework regulating government hacking—in particular, the use and disclosure of software vulnerabilities.

The United States, perhaps uniquely among nations, owes its existence in no small part to its people's outrage against government invasions of privacy. The Founders' abhorrence of the general warrants and writs of assistance wielded by the British crown left its mark on our Constitution in the form of the Fourth Amendment's guarantee that our persons, homes, and papers shall remain secure against unreasonable government searches. In our more recent history, the systematic abuse of surveillance authorities uncovered by the Church Committee of the 1970s provided a sobering reminder of how readily the powers we grant government to protect our democracy can be perverted to threaten it.

As we face a daunting array of novel 21st-century threats, from violent global terror groups to sophisticated cybercriminals, Americans routinely hear that we can purchase our safety only by giving up essential liberty, that our Founders' resistance to government intrusions is a luxury we can no longer afford in a dangerous world, and that our commitment to liberty and limited government is a weakness and a source of vulnerability. In the coming years, legislators will confront that Faustian bargain in myriad

forms—but a Congress guided by reason rather than fear will consistently reject it.

Close Section 702's "Backdoor Search" and "About Search" Loopholes

In 2008, Congress amended the Foreign Intelligence Surveillance Act of 1978 (FISA), empowering the director of national intelligence and the attorney general to jointly authorize programmatic interception, at domestic communications facilities, of communications pertaining to foreign intelligence targets. Under Section 702 of that statute, the Foreign Intelligence Surveillance Court (or FISA court) approves only broad targeting and minimization procedures governing such collection, whereas the selection of specific targets and accounts to be collected is left to the discretion of National Security Agency (NSA) analysts.

Although only non–U.S. persons located abroad may be formally targeted under these general warrants, the massive scale of collection nevertheless ensures that enormous numbers of American communications are swept up by the NSA. In 2015, more than 94,000 foreign "persons"—potentially including corporate entities—were "targets" of Section 702 collection. A 2014 review by the Privacy and Civil Liberties Oversight Board (PCLOB) noted that, by 2011, the NSA was collecting more than 250 million Internet communications annually under this authority alone; the review also noted that the current number was "significantly higher." Though collection must be conducted for some legitimate foreign intelligence purpose, there is no statutory requirement that the particular accounts identified for interception belong to a terrorist or other foreign agent.

The PCLOB's review of Section 702 indicates that, unlike the bulk telephony metadata program ended by the USA Freedom Act of 2015, such surveillance has yielded intelligence of significant value. Less clear is whether an essential component of Section 702's utility is the collection of communications of identifiably U.S. persons—not targeted in themselves but incidental to the collection of targeted communications. The Framers of the Constitution did not prohibit general warrants on the premise that they would never yield valuable information about criminal conduct; clearly they would. The relevant question is whether the marginal benefit of general searches, relative to what could be obtained with more traditional particularized warrants, is so enormous as to justify the ancillary invasion of the privacy rights of many thousands of Americans.

Over the longer term, then, Congress should authorize a thorough inquiry into whether the value of Section 702 collection would be materially diminished by requiring additional judicial approval for the collection of communications to or from accounts known or reasonably believed to pertain to U.S. persons, even when such collection is incidental to the warrantless targeting of foreigners. The Fourth Amendment, after all, guarantees citizens a right to be secure against unreasonable *searches*, not unreasonable "targeting": the fact that general warrants do not explicitly target the persons they render subject to search has not traditionally been understood as a mitigating factor, but rather a key component of what makes them so onerous.

Ideally, then, collections under Section 702 would be limited—to the greatest extent feasible—to foreign–foreign communications. Thus, providers would have to segregate messages between foreign targets and users identifiably based in the United States before sending the foreign–foreign communications to the NSA. Such messages could be retained by providers in case subsequent scrutiny establishes probable cause for a warrant to obtain them. Providers themselves frequently retain quite accurate information about the geographical location of their users for their own business purposes. Thus, they should often be able to conduct such segregation without the need for additional government scrutiny of communications for the purpose of locating the participants in the conversation.

In the interim, Congress should, at minimum, close the two loopholes that raise the most significant constitutional and practical concerns about the overcollection and potential misuse of U.S. citizen communications: the so-called "backdoor search" and "about search" loopholes. Though Section 702 authorizes only the targeting of foreign persons for intelligence purposes, the subsequent querying and use of the data collected (including, of course, the communications of American citizens) is less stringently restricted. Databases containing the fruits of the PRISM data-collection program—that is, Section 702 collection directly from, and with the participation of major U.S. Internet communications platforms—are made available to cleared analysts, at both the NSA and other intelligence agencies, and can be queried using U.S. person "identifiers." In 2015, intelligence agencies *other than the Federal Bureau of Investigation* (FBI) retrieved raw communications content using such queries 4,672 times. The FBI is statutorily exempt from tracking or reporting the frequency with which it performs such queries but has acknowledged that it does so routinely. Thus, the true total number of "backdoor" queries is likely at least an order of magnitude higher.

Under current law, then, FBI agents—even those conducting preliminary investigations not predicated on any hard evidence of wrongdoing—may deliberately search for and obtain the private communications of U.S. persons in these vast data stores, even though a warrant based on probable cause would be required to obtain such communications directly. Perversely, the FBI is exempt from reporting to Congress or the public on the frequency of these backdoor searches precisely because they apparently occur so routinely that officials have indicated it would be infeasible even to attempt to quantify them. This point is particularly disturbing in light of press reports that law enforcement agencies engage in a practice known as "parallel construction" to conceal from both courts and defendants the intelligence origins of electronic communications evidence introduced in criminal trials.

Congress should therefore act to ensure that broad powers justified by the exigencies of foreign intelligence cannot be surreptitiously used to circumvent the safeguards that properly govern criminal investigations. The FBI, like other agencies with access to Section 702 databases, should be required to design its computer systems to facilitate the automatic logging and classification of queries to those databases. That way, Congress and other oversight bodies can be adequately informed about how the information collected is being used. Analysts should be informed when intelligence databases contain results responsive to a query on a U.S. person identifier. However, if a judicial warrant founded on probable cause would be required to *directly* target a person or account, then law enforcement should be held to the same standard to access communications in Section 702 databases.

The second major loophole Congress should address is the use of so-called "about searches," an element of the "upstream collection" the NSA conducts by filtering traffic flowing over the Internet backbone. Until relatively recently, the general public believed—and the government even falsely represented to the Supreme Court—that Section 702 authorized the acquisition only of communications either sent to or originating from an account reasonably believed to belong to a foreign target. In fact, as we now know, the NSA engages in mass filtering of the *contents* of international Internet communications, which it also uses as a basis for acquisition. Thus, for example, an email from an American citizen to any person abroad may be acquired by the NSA if it merely *mentions* the email address or other electronic identifier of an intelligence target, even though neither the sender nor the recipient is designated as a target, and neither

the sending nor receiving account has been tagged for collection. Though the FISA Amendments Act forbids the intentional acquisition of wholly domestic communications, the FISA court estimated in 2011 that, under the "upstream" procedures then in place, the NSA would likely acquire some 56,000 wholly domestic emails annually—a result of the technical difficulty of segregating the domestic from the international emails that might be received or transmitted by the same user during a single online session. Although the procedures at issue in that case were subsequently modified by order of the FISA court, the broader practice of "about" searching persists.

These searches raise especially acute constitutional concerns. The legality of warrantless Section 702 collection is predicated on the idea—never explicitly affirmed by the Supreme Court—that such collection falls within a "foreign intelligence exception" to the Fourth Amendment's presumptive requirement that searches of the contents of Americans' communications be authorized by a particularized warrant founded on probable cause. Declassified FISA court opinions have articulated a two-pronged test defining the limits of this exception. Surveillance must be conducted "to obtain foreign intelligence for national security purposes" *and* must be "directed against foreign powers or agents of foreign powers reasonably believed to be located outside the United States."

According to the intelligence community's traditional understanding of these terms, the "target" of surveillance is the person or entity *from or about whom* information is sought (typically but not necessarily a party to the intercepted communication), whereas surveillance is "directed against" the communications facility that either originates or receives an intercepted message. Because Section 702 does not require that its foreign targets be agents of foreign powers, it is not clear that the exception covers the interception of communications between a U.S. person and foreign persons whose accounts are targeted for either upstream or PRISM collection. It does seem clear, however, that the exception cannot plausibly be stretched to accommodate searches directed at *neither* the sending nor receiving account and, indeed, conducted without regard to whether the sender or receiver is even an intelligence target, let alone a suspected foreign agent.

In addition to the constitutional concerns, Section 702 has created an international backlash, with potentially serious consequences for global digital commerce. In 2015, the Court of Justice of the European Union (EU) cited Section 702 in a ruling invalidating the "Safe Harbor" arrangement governing commercial transfer of personal data about EU citizens

to U.S. firms. Despite subsequent efforts to negotiate a new agreement addressing European concerns, the risk of an adverse ruling in future cases remains high as long as Section 702 is perceived as effectively granting the government discretionary access to the private data of foreign persons held by American firms. More transparent and restrictive targeting rules limiting the applicability of Section 702 to suspected foreign agents would substantially mitigate this risk.

Congress should therefore amend Section 702 to ensure that collection pursuant to this authority, at a minimum, falls within the bounds of the warrant exception articulated by the FISA court and to clarify that the acquisition of content entering or leaving the United States is limited to communications whose sender or intended recipient is a valid intelligence target. In cases where the sender or recipient of a message, whether acquired via upstream or PRISM collection, *is* a Section 702 target but has not been affirmatively determined to be an agent of a foreign power, the NSA should be required to develop procedures designed to minimize, to the greatest practicable extent, the collection, retention, or dissemination of communications to or from identifiable U.S. person accounts.

Update the Electronic Communications Privacy Act to Provide Meaningful Protection for Stored Communications and Location Data

Although intelligence surveillance has received the lion's share of public attention in recent years, our increasing reliance on digital communications technologies means that ordinary law enforcement agencies, too, depend increasingly on electronic data gathering in the course of criminal investigations. Yet in contrast to intelligence authorities, which have been amended many times since 2001, they do so largely under the aegis of the increasingly outdated Electronic Communications Privacy Act (ECPA) of 1986.

The structure of ECPA may have made sense at the time of passage, but the law is now dramatically out of step with the realities of 21st-century communications practices. It makes unclear distinctions between "remote computing" and "electronic communications" services that are difficult for both government lawyers and technology companies to apply coherently to the vast array of online services Americans use. Inconsistent levels of protections may be applied to different types of electronic data—and even to the same communication at different times. Perhaps most egregiously, ECPA authorizes law enforcement agencies to obtain the contents of private emails without satisfying the requirements for a proba-

ble cause search warrant, depending on factors such as the amount of time a message has been in storage or even (according to one Justice Department interpretation) whether it has been read by the recipient. As a growing number of courts have already held, these provisions violate the Fourth Amendment.

Congress should amend ECPA to establish a uniform requirement, consistent with the Fourth Amendment, of a probable cause search warrant to obtain the contents of both private electronic communications and remotely stored personal data not available to the general public. Though major communications providers, backed by several appellate courts, have already successfully insisted that they will produce user content only pursuant to a warrant, that requirement should be codified in statute to ensure clarity and consistency for both police and providers. (This would not, of course, affect the ability of government agencies to continue serving subpoenas directly to the owners of stored data, just as they would for data stored locally on a user's hard drive.)

The warrant requirement should also apply to at least some forms of communications metadata, which both privacy advocates and many law enforcement officials acknowledge is increasingly as sensitive and revealing as communications' content. Detailed Internet transactional logs, for example, often effectively reveal a user's detailed reading habits, or vitiate the First Amendment right to speak anonymously online, as surely as any wiretap designed to capture the contents of those data transactions. Yet ECPA adopts the mechanical assumption that all transactional data stored by a third party—even data never normally reviewed by any human observer—falls outside the protection of the Fourth Amendment and is subject to compulsory production under standards far less stringent than probable cause. Although some types of communications records, such as "basic subscriber information," should reasonably be available to law enforcement via subpoena or court order, judges should be afforded greater discretion to impose the higher Fourth Amendment standard of probable cause when investigators seek Internet transactional data that is either functionally equivalent to communications content or otherwise implicates core privacy interests. The mere fact of third-party custodianship should not be the sole factor in determining whether government acquisition of such transactional data implicates citizens' reasonable expectations of privacy.

Geolocation data, whether obtained via prospective Global Positioning System (GPS) tracking of a subject or from such sources as cellular connec-

tion records, similarly enables increasingly precise monitoring of Americans' physical movements and patterns of activity, in both public and private spaces. In 2012, a unanimous Supreme Court held in *U.S. v. Jones* that the installation of a GPS tracking device on a vehicle—especially when used for protracted monitoring—constitutes a search subject to the requirements of the Fourth Amendment. Congress should recognize that the privacy interest invaded by location tracking does not depend on the details of the technical mechanism by which the tracking is accomplished and should establish a uniform warrant standard for electronic location surveillance.

Protect the Integrity of Strong Encryption Technology against Demands for Government Backdoors

As high-profile cyberattacks regularly demonstrate the vulnerability of Americans' most sensitive data to malicious actors—from domestic criminals to foreign governments—we increasingly (and often unwittingly) rely on the critical protection of strong data encryption. Indeed, the flourishing digital economy we all now take for granted is in significant measure a product of the government's decision, in the late 1990s, to ease export restrictions on strong encryption software.

Recently, however, some law enforcement officials have issued renewed calls—wisely rejected when they were first heard more than two decades ago—for legislation requiring communications services and technology manufacturers to design deliberately insecure products, with built-in backdoors enabling law enforcement to unlock encrypted data. Unbreakable encryption has long been available for traditional personal computers—refuting dire prophecies that such software would quickly render criminal investigations all but impossible. Now, the increasing deployment of default encryption on mobile computing devices, and in digital communications platforms such as instant messaging services, has resurrected the idea that companies must be prohibited from selling Americans "too much" privacy or security.

Such demands are not only offensive in principle but would be futile and destructive in practice. The principled problem should be all too clear: a backdoor mandate effectively treats millions of law-abiding Americans as presumptive criminals who may be forced to store their own private data, not in a format of their own choosing but in one dictated by the government. Such a proposal applied to more traditional forms of communication—a mandate that Americans tape their verbal conversa-

tions for the convenience of police or ensure that their personal diaries are legible to government investigators—would be obviously abhorrent. It is no less offensive when our thoughts and conversations are mediated by digital bits rather than air or paper.

The practical pitfalls of backdoor mandates are nearly as obvious to technologists and security professionals. First, experts broadly agree that it is extremely difficult, if not impossible, to build a "backdoor" that opens for law enforcement officers without simultaneously rendering the technology less secure and more vulnerable to other attackers, including repressive foreign governments. Though secure mechanisms for "exceptional access" by law enforcement have been described in theory, the general consensus of security experts is that they are extremely unlikely to be securely implementable at scale across many thousands of providers in a rapidly changing software ecosystem requiring frequent updates and patches to adapt to newly discovered bugs, vulnerabilities, and threats.

Second, unbreakable encryption tools are already widely available. Sophisticated cybercriminals—those for whom such digital evidence is most likely to be critical to an investigation—will not rely on products with backdoors to protect their private data; instead, they can choose from an array of widely available, secure products regardless of any mandates the United States chooses to impose. Indeed, several recent surveys of the current technological landscape have found that a substantial majority of widely used encrypted messaging tools are produced either by foreign firms or via a globally distributed "open source" model of development untethered to any particular physical location.

Third, and in consequence of the previous point, such mandates would hobble American companies in the global technology marketplace, even as individual and corporate consumers alike are increasingly demanding robust assurances of data security. This concern is particularly acute in the cloud computing sector. Firms conducting sensitive corporate communications or storing valuable intellectual property will naturally want assurances that their data will not be improperly accessed by the employees of any company entrusted with the data. The simplest way to provide that assurance is to leave the encryption keys for cloud-stored data in the hands of the end users, rendering it unintelligible to either hackers or unscrupulous employees. A backdoor mandate would ensure that only non-U.S. companies could provide such assurances.

Fourth and finally, any effective mandate would impose design constraints on programmers and manufacturers far more drastic than most

nontechnologists recognize, creating pressure to adopt more centralized (and so more easily monitored) communications protocols and to make device-operating systems more opaque and resistant to modification by their own users and owners. Requiring developers to comply with government demands for unencrypted data would create an implicit bias in favor of centralized over peer-to-peer communications protocols (for which a secure backdoor is intrinsically more difficult to design) and in favor of closed and proprietary over open-source software development, regardless of which approach would be superior on the technical merits.

In short, Congress should recognize that any legislative attempt to deny Americans access to strong privacy technologies would be economically injurious, practically feckless, technologically uninformed, and morally offensive.

Develop a Statutory Framework Regulating Government Hacking

For both intelligence agencies and ordinary law enforcement, the ability to conduct effective investigations increasingly turns on the ability to access digital communications and other stored data—data that are often encrypted, beyond the easy physical research of investigators, or stored on computers whose geographic location is (at least initially) unknown to the government. As a result, these agencies have found it necessary to develop and deploy capabilities for surreptitious remote access to computer systems—or, more prosaically, government hacking capabilities. Yet to date, this process has not unfolded pursuant to any coherent legislative framework, but via a patchwork of internal guidelines, interagency memoranda, rules committee hearings, and warrant applications to low-level judges with limited technical expertise. These fora are inappropriate for balancing the complex constitutional and policy questions raised by government hacking.

Perhaps the simplest step legislators can take toward providing the necessary framework for government hacking is to formalize and codify the Vulnerabilities Equities Process. This process is currently used by the intelligence community to determine when software vulnerabilities identified by intelligence agencies should be disclosed to developers and when they should be retained for intelligence gathering purposes. As White House cybersecurity coordinator Michael Daniel explained in a 2014 blog post, this process is appropriately biased toward disclosing software vulnerabilities to developers so that they can be patched. "Building up a huge stockpile of undisclosed vulnerabilities while leaving the Internet

vulnerable and the American people unprotected," Daniel explained, "would not be in our national security interest."

There are, however, causes for concern with the status quo. Established in 2010, the interagency vulnerability review process appears to have fallen into disuse until being "reinvigorated" by the Obama administration in 2014. Moreover, no statute or executive order requires participation in the process, meaning it could easily be weakened or even abandoned entirely under future administrations. The process is also unnecessarily opaque, with few mechanisms for holding the Equities Review Board—the agency within the NSA tasked with making disclosure determinations—accountable, either to overseers or to the general public. This lack of accountability unnecessarily undermines confidence in the soundness of the process—and may make firms and security researchers wary of collaborating closely with the government.

Congress should formally establish an independent Equities Review Board comprising both members of the intelligence community and cleared representatives of the technology sector and require that vulnerabilities discovered by government agencies be promptly submitted to the vulnerabilities review process. Whereas particular disclosure determinations will properly remain classified, the general principles and guidelines used to arrive at those determinations should be public. In general, the presumption should be that any vulnerability in software used by the private sector or general public must be disclosed eventually—and in most cases immediately. In the rare cases when the balance of considerations favors delaying disclosure of a vulnerability so that it can be retained for intelligence or law enforcement use, that determination should be reviewed at regular intervals, with disclosure as the default in the absence of a continuing compelling interest in retaining it. Statistical information about the average delay between discovery and disclosure of a vulnerability should be made publicly available, and a sampling of specific determinations should be subject to review by the appropriate inspectors general.

Of more direct relevance to hacking by law enforcement, Congress should act to supplant a recent amendment to Federal Rule of Criminal Procedure 41 permitting broad extrajurisdictional warrants for digital searches. Under the revised Rule 41, law enforcement agencies may apply for warrants to remotely search computers outside the jurisdiction in which the warrant is issued when the location of the target computers "has been concealed through technological means" or when more than five target computers "have been damaged without authorization and are located in

five or more districts." The latter provision is generally understood as authorizing the issuance of broad warrants to compromise and identify computer systems that have been infected by criminal "botnets."

These amendments raise serious concerns about both extraterritoriality and Fourth Amendment particularity. When search warrants are issued for computers that cannot be reliably located in the physical world, it is all but certain that some will prove to be outside the United States. In practice, then, the amendment authorizes the extraterritorial enforcement of U.S. search warrants, in likely violation of the law of the country in which the target computer is located. International agreements, not the determinations of magistrate judges, provide the appropriate process for regulating such potential cross-border searches.

In addition, the FBI has already obtained court approval in at least some cases for so-called "watering hole" searches, in which large numbers of computers accessing government-operated sites and purporting to offer illicit content are remotely compromised, raising novel questions about the appropriate standard of particularity for authorizing such searches. In the case of government hacking to identify botnet victims, this lack of particularity is all but guaranteed—with the added difficulty that the targets are the purported victims, rather than perpetrators, of a crime. And in both cases, the enormous variety of computer systems and software configurations that would be targeted by any large-scale government exploitation make it difficult to ensure that a government-installed exploit would not damage the targeted systems or otherwise interfere with their normal operations.

At a minimum, Congress should restrict the use of hacking tools against either targets of unknown location or botnet victims to the purpose of identifying the computer systems in question, in cases where no less intrusive means of identification is available. This restriction would allow investigators to seek an appropriately particularized warrant in the former case and to notify the victims in the latter case. It would also minimize the danger of unanticipated side effects on the targeted machines and reduce the risk of hacking warrants being used to facilitate fishing expeditions for evidence of criminal conduct unrelated to the initial purpose of the warrant.

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—Prepared by Julian Sanchez

12. Civil Asset Forfeiture Reform

Congress should

- amend the Civil Asset Forfeiture Reform Act to require, in most cases, that a criminal conviction be obtained before assets may be forfeited to the government;
- prohibit federal agencies from "adopting" state or local asset forfeiture cases and engaging in the "equitable sharing" of any forfeited property in such cases;
- require that forfeited property be assigned to the federal treasury rather than to the agencies executing the forfeiture;
- short of those reforms, adopt stronger nexus and proportionality requirements for asset forfeitures and require proof by a clear and convincing standard; and
- require the government to have the burden of proof in establishing that someone is not an "innocent owner."

American asset forfeiture law has two branches. One, *criminal* asset forfeiture, is usually fairly straightforward, whether it concerns contraband, which as such may be seized and forfeited to the government, or ill-gotten gain and instrumentalities. Pursuant to a criminal conviction, any proceeds or instrumentalities of the crime are subject to seizure and forfeiture. Courts may have to weigh the scope of "proceeds" or "instrumentalities." Or they may have to limit statutes that provide for excessive forfeitures. But forfeiture follows conviction, with the usual procedural safeguards of the criminal law.

Not so with *civil* asset forfeiture, where most of the abuses today occur. Here, law enforcement officials often simply seize property for forfeiture on mere suspicion of a crime, leaving it to the owner to try to prove the *property's* "innocence," where that is allowed. Unlike in personam criminal

actions, *civil* forfeiture actions, if they are even brought, are in rem—brought against "the thing" on the theory that it "facilitated" a crime and thus is "guilty."

Forfeiture outrages span the country. In Volusia County, Florida, police stop motorists going south on I-95 and seize any cash they're carrying in excess of $100 on suspicion that it's money to buy drugs. New York City police make DUI (driving under the influence) arrests and then seize drivers' cars. District of Columbia police seize a grandmother's home after her grandson comes from next door and makes a call from the home to consummate a drug deal. Officials seize a home used for prostitution and the previous owner, who took back a second mortgage when he sold the home, loses the mortgage. In each case, the property is seized for forfeiture to the government, not because the owner has been found guilty of a crime, but because the property is said to "facilitate" a crime, whether or not a crime was ever proven or a prosecution even begun. And if the owner wants to try to get his property back, the cost of litigation, to say nothing of the threat of an in personam criminal prosecution, often puts an end to that.

Behind all of these seizures are perverse incentives: the police themselves or other law enforcement agencies usually keep the forfeited property—an arrangement rationalized as a cost-efficient way to fight crime. The incentives thus skew toward ever more forfeitures. Vast state and local seizures aside, according to federal government records, Justice Department seizures alone went from $27 million in 1985 to $556 million in 1993 to nearly $4.2 billion in 2012. Since 2001, the federal government has seized $2.5 billion without either bringing a criminal action or issuing a warrant.

Grounded in the "deodand" theories of the Middle Ages when the "goring ox" was subject to forfeiture because "guilty," this practice first arose in America in admiralty law. Thus, if a ship owner abroad and hence beyond the reach of an in personam action failed to pay duties on goods he shipped to America, officials seized the goods through in rem actions. Except for such uses, forfeiture was fairly rare until Prohibition. With the war on drugs, it again came to life. And today, officials use forfeiture well beyond the drug war. As revenue from forfeitures has increased, the practice has become a veritable addiction for federal, state, and local officials across the country, despite periodic exposés in the media.

There will be some cases, of course, in which the use of civil asset forfeiture might be justified simply on the facts, as in the admiralty case

just noted. Or perhaps a drug dealer, knowing his guilt but knowing also that the state's evidence is inconclusive, will agree to forfeit cash that police have seized, thereby to avoid prosecution and possible conviction. That outcome is simply a bow to the uncertainties of prosecution, as with any ordinary plea bargain. But the rationale for the forfeiture in such a case is not facilitation—it's alleged ill-gotten gain. By contrast, when police or prosecutors, for acquisitive reasons, use the same tactics with *innocent* owners who insist on their innocence—"Abandon your property or we'll prosecute you," at which point the costs and risks surrounding prosecution surface—they are employing the facilitation doctrine to justify putting the innocent owner to such a choice. In those cases, the doctrine is pernicious: it's simply a ruse—a fiction—serving to coerce acquiescence.

Because it lends itself to such abuse, therefore, the facilitation doctrine should be unavailable to any law enforcement agency once an owner challenges a seizure of his property. Once he does, the government should bear the burden of showing not that the *property* is guilty but that the *owner* is; therefore, his property may be subject to forfeiture if it constitutes ill-gotten gain or was an instrumentality of the crime, narrowly construed (e.g., burglary tools, but not cars in DUI arrests or houses from which drug calls were made). In other words, once an owner challenges a seizure, *criminal* forfeiture procedures should be required. Indeed, "civil" asset forfeiture, arising from an allegation that there was a *crime*, is essentially an oxymoron. The government should prove the allegation, under the standard criminal law procedures, before any property is forfeited.

Many of these abuses take place at the state level, of course. Yet Congress can take steps not only to reform federal law—which often serves as a model for state law—but to affect state law as well. The Civil Asset Forfeiture Reform Act of 2000, brought to fruition by the efforts of the late Rep. Henry J. Hyde of Illinois, made several procedural reforms, but it left in place the basic substantive problem, the "facilitation" doctrine. The abuses have thus continued, so much so that two former directors of the Justice Department's civil asset forfeiture program recently wrote in the *Washington Post* that "the program began with good intentions but now, having failed in both purpose and execution, it should be abolished."

If that is not possible, Congress should make fundamental changes in the program. In particular, if a crime is alleged, federal law enforcement officials should have power to seize property for subsequent forfeiture under only three conditions: (1) when in personam jurisdiction is not available, as in the admiralty example above; (2) when, in the judgment

of the officials, the evidence indicates that a successful prosecution is uncertain, but there is a high probability that the property at issue is an ill-gotten gain from the alleged crime *and the target does not object to the forfeiture*, as in the drug-dealer example above; and (3) when the property would be subject to forfeiture following a successful prosecution, and there is a substantial risk that it will be moved beyond the government's reach or otherwise dissipated prior to conviction; but such seizures or freezes should not preclude the availability of funds sufficient to enable the defendant to mount a proper legal defense against the charges, even though some or all of the assets may be dissipated for that purpose.

Those reforms would effectively eliminate the facilitation doctrine, except for a narrow reading of "instrumentalities," and would largely replace civil forfeiture proceedings with criminal proceedings. Still, the doctrine may continue to be employed by state and local officials. Because of that, and from respect for federalism more broadly, Congress should prohibit the practice of "adoption" or "equitable sharing" whereby federal agencies adopt cases brought to them by state and local enforcement agencies, then share the forfeited assets with those agencies. The usual motive is to circumvent state restrictions aimed at stopping abuses by requiring, for example, that forfeited assets be directed to state education departments rather than kept by the state or local law enforcement agencies. Thus, here again, forfeiture's perverse incentives drive this practice while undermining state autonomy in the process.

Consistent with that reform, Congress should put an end to the underlying incentive structure by requiring that forfeited assets be assigned to the federal treasury rather than to the enforcement agencies—which should not be allowed, in effect, "to police for profit." In 2013, the federal Asset Forfeiture Fund exceeded $2 billion, having more than doubled since 2008 and increased twentyfold since it was created in 1986. Not coincidentally, the growth in civil asset forfeiture closely parallels the ability of law enforcement agencies to profit from their activities. In fact, a veritable cottage industry has arisen that instructs officers how to stretch their legal authority to the absolute limit and beyond. It's a system that more resembles piracy than law enforcement.

At the least, if the reforms suggested here are not made, Congress should require the government to show, if challenged, that the property subject to forfeiture had a significant and direct connection to the alleged underlying crime, not simply that it was somehow "involved" in the crime, as now. And the standard of proof should be raised from a mere preponderance

of the evidence, again as now, to clear and convincing evidence. Similarly, a proportionality requirement should be imposed to ensure that the government does not seize property out of proportion to the offense. Congress should require officials to consider the seriousness of the offense, the hardship to the owner, the value of the property, and the extent of a nexus to criminal activity. If a son living in his parents' home is convicted of selling $40 worth of heroin and officials try to take the home, as recently happened in Philadelphia, a proportionality requirement ensures that prosecutors cannot take a home for a $40 crime.

Finally, assuming that the facilitation doctrine is not eliminated, current law affords an innocent owner defense, but the burden is on the owner to prove his innocence by a preponderance of the evidence. Just as people enjoy the presumption of innocence in a criminal trial, property owners never convicted or even charged with a crime should not be presumed guilty in civil asset forfeiture proceedings. The burden of proof should be on the government to prove, by clear and convincing evidence, that the owner knew or reasonably should have known that the property facilitated a crime and he did nothing to mitigate the situation or that the property reflected the proceeds of a crime.

The Civil Asset Forfeiture Reform Act of 2000 has proven inadequate for curbing abuses as countless Americans across the nation, having done nothing wrong, continue to lose their homes, businesses, and, sometimes, their very lives to the aggressive, acquisitive policing that this law encourages. There is broad agreement today that Congress should act quickly and decisively to fix a system that is badly in need of reform.

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—Prepared by Roger Pilon and Trevor Burrus

13. Immigration

Congress should

- allow states to regulate, operate, and run their own migrant worker programs under federal supervision;
- create a large national guest worker visa program for lower-skilled migrants;
- reform the H-1B visa program for highly skilled migrant workers by eliminating the cap, allowing more portability, and deregulating the hiring process;
- reform and simplify the Department of Labor's approval process for foreign workers;
- expand legal immigration opportunities by deregulating and expanding employment-based green cards;
- repeal legislative bars that limit illegal immigrant legalization; and
- restrict noncitizen access to means-tested welfare.

The American immigration system is unsuited to the modern economy. Too few pathways for legal migration combined with high domestic demand for workers have created a large population of 11–12 million illegal immigrants. Additionally, onerous quotas and regulations have made it impossible for them to legalize. Many legal immigrants have to wait years for their green cards if they can get them at all. These problems put a drag on U.S. economic growth and increase the scale and scope of illegal activity in black markets. Short of comprehensive reform, piecemeal changes that expand legal immigration and legalize illegal immigrants are sorely needed. The history of America's immigration system provides some context for understanding these problems and how to fix them.

Immigration History and Lessons from the Past

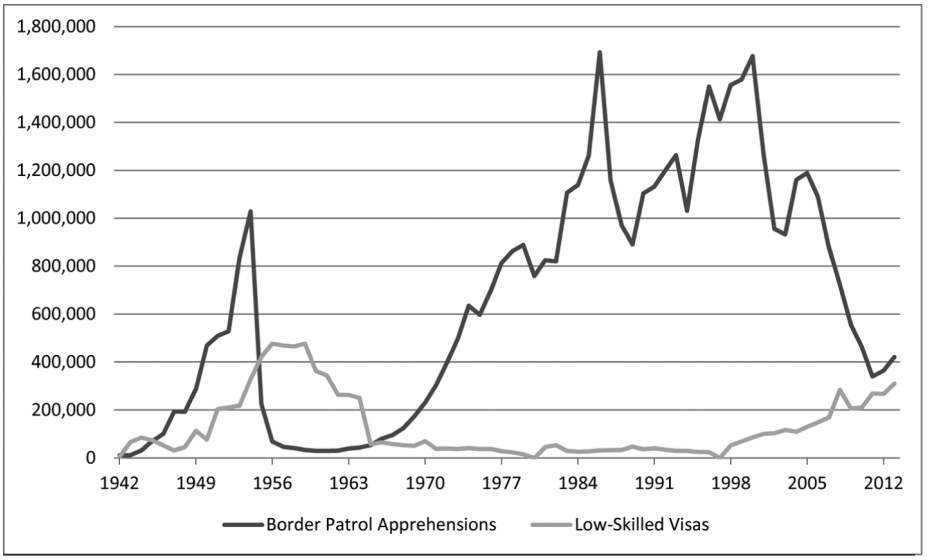
From 1790 to 1875, the federal immigration policy was essentially one of open borders. Any immigrant from any country could legally enter, live, and work in the United States. During that period the only regulations related to immigration controlled who could become a citizen. However, beginning in 1875 and accelerating through the Progressive Era, Congress increasingly regulated legal immigration. By the early 1920s virtually all legal immigration from outside the Western Hemisphere was impossible. Some of those restrictions made sense, like limitations on criminals and those with serious contagious diseases. Others, like the bans on Chinese immigrants, were fueled by illegitimate concerns founded on racism or labor market protectionism. During the Great Depression and World War II, immigration was not an important issue, but after the end of hostilities a new phenomenon arose: illegal immigration.

During America's first period of relatively open immigration, very little of it was illegal because legal entry was so easy. After the United States ended the period of open immigration in the 1920s, the Great Depression and World War II effectively limited U.S. immigration. The booming postwar economy demanded laborers. Because immigration was closed off, American employers began to hire immigrants who were willing to enter unlawfully. By the early 1950s there were more than 2 million illegal immigrants in the United States, mostly from Mexico, but by 1955 their numbers had fallen by over 90 percent. What happened?

Two new policies drastically reduced the population of illegal immigrants. The first affected the economic demand for illegal workers by expanding the supply of legal migrant workers through deregulation of the Bracero guest worker visa program for agricultural workers. The Bracero visa allowed an uncapped number of Mexicans to work temporarily in agriculture in the United States. The workers could go back and forth so long as they did not violate the terms of the visa or commit serious crimes. Mexicans could acquire the visa easily, and American farmers faced very few hurdles in hiring Braceros. As a result, farmers began to favor Braceros, and the number of illegal entries collapsed beginning in the early 1950s (Figure 13.1).

The second policy was a stepped-up enforcement program. Because of the creation of the Bracero visa, Border Patrol and immigration enforcement became far more effective at identifying illegal immigrants in the United States. Because farmers were guaranteed legal workers, they cooperated with the government in identifying illegal workers. The government

Figure 13.1
Apprehensions of Illegal Immigrants and Visas for Low-Skilled Guest Workers

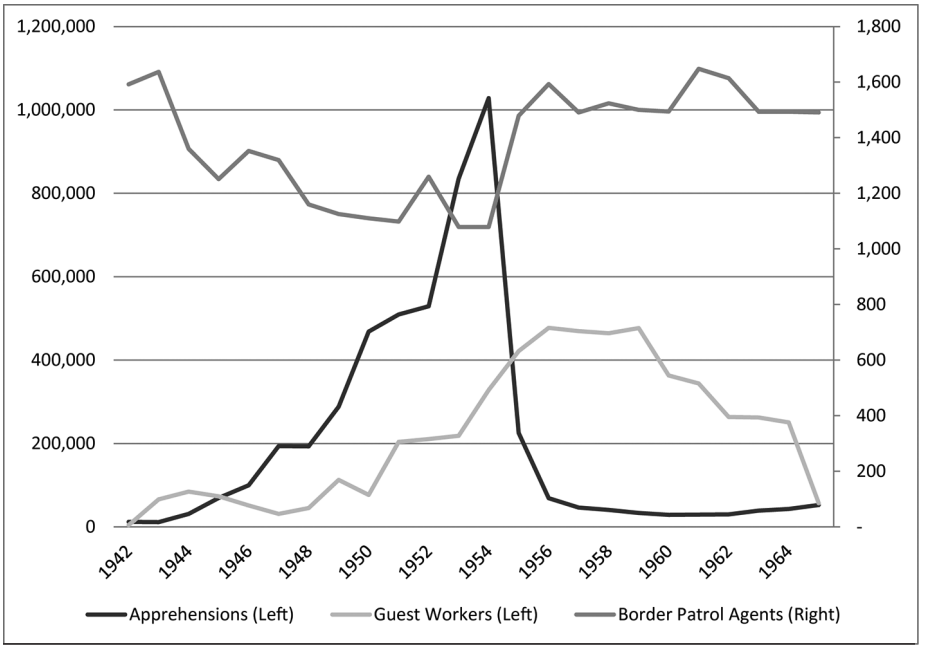


SOURCE: Customs and Border Protection and Citizenship and Immigration Services. Department of Homeland Security, "Yearbook of Immigration Statistics," Office of Immigration Statistics, 1996–2014 editions and Immigration and Naturalization Service, "Annual Reports," 1942–1986 editions.

deported many illegal workers but also legalized many on the spot and drove others down to the border to allow them to reenter legally on a Bracero visa—often on the same day. As a result, since Mexican workers were able to enter legally, the supply of illegal immigrants dried up. This two-pronged approach decreased the size of the illegal immigrant population by upward of 90 percent without a large increase in the size of Border Patrol—just a better migration system and a Border Patrol that guided migrants into it (Figure 13.2).

The Bracero program ultimately ended in 1964 due to a combination of intense lobbying from the United Farm Workers union and a few scandals in which Bracero workers were abused. Congress did not create a new low-skilled visa to replace the canceled Bracero program, and the handful of visas that remained in other categories could not fill the gap. The cancellation of that program did not extinguish U.S. demand for lower-skilled workers; it merely made the hiring of unlawful immigrants the only option for employers and illegal immigration the sole means of

Figure 13.2
Border Patrol Agents, Guest Workers, and Apprehensions



SOURCE: Department of Homeland Security and Immigration and Naturalization Service.

immigrating for lower-skilled workers. After 1964 the flow of unlawful immigrants steadily climbed as the new black market filled the void left by the canceled Bracero program (see Figure 13.1).

Creating a New Guest Worker Program

The United States needs a new guest worker visa program that is large, easy to apply for, and minimally regulated to incentivize employers and migrants to use it. Some changes from the earlier program will be needed to make a modern guest worker visa program effective. First, the migrant workers should be legally mobile among employers, a policy called "portability." Second, migrants need to be allowed to work in sectors of the economy that actually employ illegal immigrants, like construction, manufacturing, and other nonseasonal occupations. Third, the number of migrant visas needs to be uncapped to encourage migrants to use the legal system. Fourth, the regulations governing the visa need to be as inexpensive

and unobtrusive as possible. These policies will decrease the supply of illegal immigrants and employer demand for them.

Allowing States to Create Their Own Guest Worker Systems

Congress should also pass enabling legislation that allows states to create and regulate their own guest worker visa programs under federal supervision. In 2015, the California and Texas legislatures both proposed bills to create their own state-based programs, while Utah already has such a system on its books awaiting federal approval. The local demand for a state-based migration system exists; the federal government must merely allow it.

A state-based migration program could work in a few different ways. Under a state-based visa program, the states would establish methods by which local businesses or other entities petition for migrants. The state would submit those migrant petitions to the federal government, which would clear the migrants for admission and guarantee they meet the other criteria for admission into the United States. The workers would then be able to work and live in the state that is sponsoring them. States could form compacts with other states to share workers, select the skill or education level of future guest workers, or even use the program to grant some guest worker visas to current unlawful immigrants in important occupations.

Such a program could be modeled on Canada's highly successful Provincial Nomination Program or a similar state-based Australian system. A system of bonds, whereby workers or employers pay a fixed amount that they recoup if they follow the rules of the program, could also incentivize state governments, migrants, and employers to follow the rules of the program. The current low overstay rate for federal low-skilled guest worker visas of about 2 percent should calm the worries about state-based guest workers overstaying their visas. Allowing states to create their own guest worker visa programs could result in 50 different programs. Competition between them will reveal which migration systems are best, giving guidance to Congress on how to reform the national system.

Expanding and Deregulating the Employment-Based Green Card System and H-1B Visas

In addition to temporary worker programs, the permanent immigration system also needs reform. The employment-based green card, largely

designed for highly skilled workers, has an annual cap of 140,000 green cards. It imposes enormous fees and country-of-origin regulations that make the system costly to use for both immigrants and their prospective American employers. Worse, the administration's incorrect interpretation of statutory language guarantees that fewer than half of the green cards issued actually apply to workers, while the rest are allocated to family members.

Congress should pressure the administration to issue employment-based green cards only to the actual workers—without denying their families legal status. Enforcing the correct interpretation of the statute would effectively double the number of employment-based green cards. Furthermore, the types of workers that can enter on an employment-based green card should be expanded and the quotas removed. Since employers have to prove that they can't feasibly hire similarly skilled Americans for the jobs they are offering, they should not face a numerical cap. In particular, the arbitrary country-of-origin quotas that cause enormous backlogs for skilled immigrants from India, China, and other countries should be removed.

The employment-based green card is not the only way for highly skilled immigrants to work in the United States. The H-1B visa provides another avenue. The H-1B is a temporary visa that allows American firms to hire skilled foreign workers in specialty occupations. The number of H-1Bs issued annually for American firms is capped at 85,000: 65,000 from abroad and 20,000 for foreign graduates of American universities. When the economy is growing, these few H-1B slots for businesses frequently fill up within days of becoming available. (H-1Bs are uncapped for research occupations at nonprofit research institutes affiliated with colleges and universities, but it's businesses that are feeling the pinch.) The duration of the H-1B visa is three years, but it can be renewed for an additional three-year term. Unlike other guest worker visas, H-1B holders can apply for a green card while they are working in the United States if they find an employer willing to sponsor them. If the green card approval process takes longer than the maximum six-year duration of the H-1B visa, then the worker is allowed to work until the green card is approved or denied.

The number of H-1B visas should be uncapped, workers should be perfectly portable among occupations without ex ante government approval, their foreign-born spouses should be able to work, and the burden of onerous H-1B wage and labor market regulations should be significantly reduced. Furthermore, migrants on H-1B visas, student visas,

or other nonpermanent work visas who adjust their status to permanent residency should not be counted against the numerical caps for those categories. The history of work visas and the Department of Labor's (DoL) involvement in approving them shows how small legal tweaks can produce big, positive outcomes.

In 1952, the government created a labor certification system to guarantee that migrant workers did not affect the wages of native-born American workers. Under the original system, to deny a green card on labor market grounds, the DoL had to prove that the migrant worker would adversely impact the economic prospects of similar American workers. That institutional arrangement created a passive approval process such that the DoL denied only 10 green card applications from 1952 to 1962. The Immigration Act of 1965 reversed the process. It replaced the DoL's passive veto over green card applications with a system that forced the department to certify that every migrant worker issued a green card would not adversely impact an American worker and that the immigrant was entering an occupation with insufficient Americans able, willing, and qualified to do the job. Labor unions had lobbied for this reversal of DoL tasks because they were concerned about immigrants competing with their members for jobs. The reformed labor certification approval procedures made labor immigration far more expensive and, de facto, limited green cards to only highly skilled foreign workers.

Congress should remove the DoL's active approval role for labor certifications and labor condition applications and replace it with a passive veto. Doing so would make labor immigration less costly and streamline the current system.

Removing the 3- and 10-Year Bars

Another reform that could help legalize many illegal immigrants through the existing legal system would be the repeal of the 3- and 10-year bars. The 3-year bar states that any immigrant who stays in the United States illegally for more than six months but less than one year and then leaves the United States cannot reenter or apply for a green card for three years. The 10-year bar states that any immigrant who stays in the United States illegally for more than a year and then leaves the United States cannot reenter or apply for a green card for 10 years. Any immigrant who is subject to those bars and who tries to reenter the United States in violation of them faces a 20-year ban on reentering the United States for any reason. This is a problem because virtually all applicants for a green card or visa

have to visit a U.S. embassy or consulate abroad to apply, which, in the case of illegal immigrants, requires them to leave the Untied States, thus triggering the bars. The 3- and 10-year bars prevent between 20 percent and half of all unauthorized immigrants from using the legal immigration system *if* they find a way to regularize their status.

Building a Higher Wall around the Welfare State

Immigrant use of welfare benefits and other public services is an important problem that Congress should address. Estimates of the fiscal impact of immigration on the United States hover around zero, and immigrants and their descendants tend to pay for the government-provided services that they consume. However, this fiscal calculus can be improved by building a higher wall around the welfare state and denying means-tested welfare benefits to noncitizens. Doing so is perfectly constitutional, relatively easy to accomplish, and politically popular. Currently, poor immigrants are much less likely to consume means-tested welfare than poor Americans, but noncitizens should not have access to begin with. Cato's policy analysis, "Building a Wall around the Welfare State, Instead of the Country," provides a clear legislative path forward to achieving that goal while identifying the federal statutes that would have to change.

Conclusion

Immigration is an important public policy issue that will not be resolved with harsher enforcement or higher walls but with expanded legal immigration opportunities, legalization, and welfare reform. Congress can tackle these issues through either a piecemeal approach that addresses each of these issues individually or through comprehensive legislation that seeks to solve them all at once. Regardless of the legislative strategy, Congress should pursue fiscally prudent, market-based immigration reform that reduces illegal immigration and allows the American economy to grow.

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—Prepared by Alex Nowrasteh

14. Veterans Benefits

Congress should

- direct federal actuaries to develop annual present-value estimates of the long-term cost of all accrued veterans-benefits obligations;
- increase military pay such that all active-duty military personnel can purchase, at actuarially fair rates, a standard package of private life, disability, and health insurance benefits comparable to benefits provided by the Department of Veterans Affairs;
- privatize Veterans Health Administration facilities and physical capital, such as by transferring ownership to veterans; and
- issue risk-adjusted payments, "premium support," or vouchers to VHA-eligible veterans who are not eligible for the new system of veterans benefits.

The Department of Veterans Affairs (VA) is never more than a few months away from scandal for the poor service it provides veterans. Yet the reality of how the VA disserves veterans is far worse than any headlines suggest.

Overview

The VA spends $178 billion per year to provide various benefits to veterans, survivors, and dependents who meet various criteria. Benefits include life, disability, and health insurance. Veterans benefits are a form of compensation the U.S. government provides to employees of the U.S. Armed Forces.

The VA provides health care directly to beneficiaries through the Veterans Health Administration (VHA). The VHA is an integrated health care

delivery system: the U.S. government owns (or increasingly, leases) the facilities and employs the clinicians and other employees. At the same time that the government intervenes in countless ways to suppress private integrated health systems (see Chapters 35, 36, and 38), the federal government itself operates the nation's largest integrated delivery system.

Congress determines overall funding for veterans benefits and the allocation of VHA resources. In 2016, the VHA will spend a projected $68 billion and employ the equivalent of more than 311,000 full-time employees. In 2014, it had 9.1 million veteran-enrollees, out of a total population of 21.6 million veterans, and treated 6.6 million patients, 89 percent (5.9 million) of whom were veterans. The remaining 11 percent (708,921) of VHA patients were spouses, dependents, and others (e.g., VHA employees who received vaccinations).

Quality

The VHA appears to outperform private providers on some quality measures. Studies generally find the VHA does better on process measures of quality (such as providing evidence-based care) but no better on outcomes (such as risk-adjusted mortality).

Researchers and journalists too often fail to appreciate that such studies are comparing two types of government-run systems, rather than comparing a government-run system to a market system. The federal government created the VHA, its integrated delivery system, and its "capitated" payment system, whereby providers receive a fixed budget to care for a population of patients. The federal government also protects the VHA from competition. Government does just as much to shape the delivery of care at "private" hospitals through Medicare's payment systems and other interventions that encourage fee-for-service payment and fragmented delivery. It likewise shields those hospitals from competition from other delivery systems. These studies thus fail to consider whether a market system could improve quality in both delivery systems by forcing each to compete on the dimensions of care where they are weak.

Coverage cannot be high quality if it is not secure. Veterans can lose access to VHA coverage at the whim of politicians and bureaucrats. If Congress adopts one Congressional Budget Office proposal, 2.3 million VHA enrollees would lose eligibility (and have to pay more for coverage through Medicare, the Affordable Care Act's exchanges, or elsewhere). If

and when Congress ever gets serious about reducing federal spending, it could terminate eligibility or particular benefits for even more veterans.

An Unresponsive Bureaucracy

The most obvious example of poor quality at the VHA is long waits for care. Wait times for care are longer in some areas and tend to persist because the VHA does not have a price mechanism to move resources from low- to high-value uses. Congress and the VA use a combination of politics and bureaucratic rationing to decide when and where to open and close VHA facilities, or how many clinicians to hire in each region of the country. The result is inevitable and persistent mismatches between demand and supply: shortages in some areas and gluts in others.

In 2014, whistleblowers and watchdogs discovered that 60 percent of VHA facilities were falsifying official records to make wait times appear shorter. Veterans at one facility in Phoenix were waiting 115 days for appointments. Congress responded with $5 billion to hire additional clinicians and expand VHA capacity, and $10 billion to pay for veterans to see private-sector doctors at taxpayers' expense. The additional bureaucracy associated with this option left many veterans waiting even longer than before.

Even after a media firestorm, congressional oversight hearings, and numerous VA officials losing their jobs, the Government Accountability Office (GAO) reported, "we continue to find scheduling errors that affect the reliability of wait-time data used for oversight, which make it difficult to effectively oversee newly enrolled veterans' access to primary care." According to the official data, 526,277 veterans were waiting more than 30 days for an appointment and 35,329 were waiting more than 120 days as of July 2016. And the problem of slow service extends beyond health benefits. In 2013, more than 600,000 veterans were waiting more than 120 days for disability-benefits determinations.

The flip side of shortages is gluts. Political and bureaucratic constraints make it difficult for the VHA to shut down, sell, or repurpose unneeded facilities. The VHA has increasingly turned to leasing properties, a process that makes it easier to open, close, and repurpose VHA facilities. Yet the VHA's secrecy makes it difficult even to know whether this process is more or less efficient. According to the GAO, the "VA does not . . . assess and provide information to decision makers on how it has benefited from this flexibility. Without transparency on these benefits, VA and

congressional decision makers may lack information to understand the need for these leases."

Costs

Idle capital is just one of the costs of the VHA. Supporters claim that for all its faults, the VHA provides care of comparable quality at a lower cost than Medicare or private insurance. The VHA's secrecy makes it difficult to make these comparisons. The Congressional Budget Office has testified to Congress:

> [W]ith few exceptions, VHA does not make either existing administrative data or clinical records (even with personal identifying information removed) available to researchers in other government agencies, universities, or elsewhere. . . . [I]t would be useful to know the average salaries, performance pay, and other elements of compensation that VHA provides for its physicians in various specialties and for its other clinicians; the number of patients its clinicians treat per unit of time (for example, in a typical week) and the length and intensity of those encounters; and the average prices it pays for pharmaceutical products—but VHA does not report that information publicly.

Even so, it would not be particularly surprising if a health care system subject to bureaucratic rationing and tolerant of long waits for care had lower per-unit costs, given the excessive prices government intervention allows to persist in the private sector (see Chapter 35) and Medicare (see Chapter 38).

The Real Veterans Scandal

The greatest harms the VA inflicts on veterans stem not from the services it provides, but from how it helps Congress and the president start wars. Veterans' benefits are some of the most expensive financial costs of war. The Treasury Department reports that the accrued cost of veterans' compensation and burial benefits alone had reached more than $2 trillion by 2015. That figure does not include the accrued liabilities of health care, long-term care, or life insurance benefits.

Congress does not fund veterans' benefits until they come due, often decades after sending troops off to war. Disability payments typically do not peak until 40 or 50 years after the end of a military conflict. Thus, when Congress and the president are deciding whether to commit U.S.

armed forces to battle, the VA system enables them to pretend those costs don't exist.

In an alternate universe, where Congress funded those obligations as it accrued them, Congress would have to raise money every year for future veterans benefits. It would have to raise even more in years when it was sending troops into battle, because future claims would be higher. Having to budget for the cost of additional veterans benefits, and weigh that additional cost against other priorities (e.g., entitlements, education, infrastructure), might make Congress more cautious about committing Americans to battle. When the decision to authorize military force is a close call, it could even prevent unnecessary wars.

Instead, the VA system allows Congress to ignore these costs and therefore eliminates a constraint that could prevent unnecessary wars. The very agency that exists to care for sick and disabled veterans perversely makes it more likely that veterans will end up sick, disabled, or dead.

Reporting the Cost of Accrued Veterans Benefits

Requiring transparency about the cost of future veterans benefits would be an important step toward improving veterans benefits. Congress should immediately direct federal actuaries, at the VA or other agencies, to project and report regularly on the cost of accrued veterans-benefits obligations, just as the Social Security and Medicare trustees report on those programs' accrued obligations. Simply having better information would improve debates over veterans benefits, the U.S. military, and foreign policy.

Prefunding Veterans Benefits

Congress must do more than make the current VA system transparent. Protecting veterans, active-duty personnel, and civilians requires a complete overhaul of veterans benefits. One reform would deliver better, more reliable benefits for veterans and force Congress and the president to make more careful decisions affecting the lives of active-duty personnel: Congress should fund veterans benefits in advance by increasing pay for all active-duty personnel. Each individual service member would receive a pay raise sufficient to allow her to purchase, from private insurers at actuarially fair rates, a statutorily defined package of life, disability, and health care benefits comparable to what the VA offers. Benefits would cover losses related to an enlistment or commission, beginning when she leaves active duty. Military personnel would be free to purchase more or less coverage than

the standard benefits package. Veterans could receive benefits from the insurance carriers and health care providers of their choice, rather than be limited to a single, government-run health system.

Congress should peg pay raises for each job type to the actual premiums (e.g., the second-lowest, median, or average premium) that competing insurers charge to cover personnel in each position. Insurers would be free to set actuarially fair premiums. Premiums—and the corresponding pay raises—would be higher for paratroopers than desk jockeys, so all personnel could afford the same package of benefits. The differences in premiums would allow military personnel to compare the relative risks of different military jobs and careers.

This veteran-centered system would provide veterans with better benefits. Rather than benefits that can disappear at the whim of a government bureaucrat, veterans would have benefits backed up by a legally enforceable contract. If you lose your benefits under the current system, the government works against you. If you lost them under a veteran-centered system, the government would work with you to restore those benefits—if things ever got that far. Private insurers and providers would be more responsive to veterans' needs; if not, veterans could fire them (see Chapter 36). Insurers who developed a VA-level reputation for mistreating veterans would have a difficult time enrolling new active-duty personnel. And if Congress privatized the VHA system by transferring ownership to veterans themselves (see below), then veterans would have the option of using an integrated health system run by veterans, for veterans.

Most important, this new system would make Congress and the president more cautious about using military force. Military action would cause insurers to increase premiums for life, disability, and health benefits to cover the increased risk, which would trigger mandatory pay increases for military personnel that Congress would have to fund. In addition to being a more honest and transparent way of providing veterans benefits, prefunding them in this manner could make Congress and the president more cautious about engaging in military action, because they would have to give up even more to get it. Revealing the costs of war to policymakers would lead to better decisions about when to begin and end wars.

Putting those funds directly in the hands of military personnel so they could purchase private life, disability, and health insurance benefits would be an indispensable component of a prefunded system. Creating yet another government trust fund would merely allow Congress to pretend it has solved problems that it has not.

A prefunded system of veterans benefits could also aid recruiting, because it would give military personnel more information about various jobs and more peace of mind about their veterans benefits. Competition among insurers and providers for cost-conscious active-duty personnel and veterans would help drive inflated private prices downward.

Privatizing VHA Facilities

In addition, to enable even greater competition in the provision of medical care, Congress should privatize VHA facilities. One approach would transfer ownership of the VHA to veterans themselves. Congress could incorporate the VHA and give ownership shares to VHA-eligible veterans on the basis of length of service or similar criteria. Shareholders would then select a management team—perhaps from current VHA personnel, veterans groups, private health systems, and/or insurers or other financial institutions with a record of serving military personnel. Privatization would increase competition in every local market where the VHA has facilities and would be a large wealth transfer to veterans.

The exact manner in which Congress transfers ownership of the VHA system to private hands is less important than that it do so as soon as possible.

Choice for Current VHA Enrollees

To maintain benefits for current veterans after privatization, Congress should provide risk-adjusted payments, "premium support," or vouchers to enable VHA-eligible veterans who cannot obtain benefits under the new system to purchase a comparable level of health care benefits from private providers. This approach could be similar to the Medicare reforms discussed in Chapter 38. With risk adjustment, veterans could afford to purchase health benefits at actuarially fair premiums.

Liberalizing and privatizing veterans benefits will result in better, more affordable, and more secure health care for veterans—and perhaps even discourage military conflicts.

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—Prepared by Michael F. Cannon

Law and Liberty

15. Congress, the Courts, and the Constitution

Congress should

- encourage constitutional debate in the nation by engaging in constitutional debate in Congress and in public discussions, as in the nation's earlier history;
- enact nothing without first consulting the Constitution for proper authority and then debating that question on the floors of the House and the Senate;
- move toward restoring constitutional government by carefully returning power wrongly taken over the years from the states and the people; and
- reject judicial nominees who do not appreciate that the Constitution is a document of delegated, enumerated, and thus limited powers.

For much of America's history, the Constitution was alive in the hearts and minds of the people and their leaders alike. They saw the document as defining them as a people animated by liberty; and they understood, albeit unevenly at times, that its basic function was to authorize and then limit the powers that were instituted through it. More often than not, therefore, measures aimed at expanding the federal government never made it out of Congress or, if they did, they were vetoed by presidents—not only on policy grounds but on constitutional grounds as well.

Today, however, in this chapter aimed at advising members of Congress about their authority and responsibilities under the Constitution, one hardly knows where to begin, so far has Congress taken us from constitutional government since the dawn of the 20th century. James Madison, the principal author of the Constitution, assured us in *Federalist* No. 45

that the powers of the new government were "few and defined." No one believes that describes Washington's powers today. Instead, Congress and the president exercise vast powers that are nowhere authorized by the Constitution as originally understood. Individuals and businesses are regulated as never before. And so undisciplined by constitutional constraints is congressional spending that our national debt today is approaching $20 trillion and growing, and our unfunded liability is well over a staggering $100 trillion.

As history demonstrates, this cannot go on. If we do not begin to restore constitutional discipline and, indeed, constitutional legitimacy, America will go the way of other nations that have ignored the basic moral, political, legal, and economic principles our Constitution was written and ratified to secure.

For a while after the realigning midterm elections of 1994 it looked like Congress was at last going to rethink its seemingly inexorable push toward ever-larger government. In fact, the 104th Congress saw the creation in the House of a 100-strong Constitutional Caucus dedicated to promoting the restoration of limited constitutional government. And shortly thereafter President Bill Clinton announced that the era of big government was over. But the spirit of that Congress lasted only a short time before the usual spending and regulating returned.

With the midterm "tea party" elections of 2010, however, the constitutional winds blew again, more strongly, so much so that on the first full day of the 112th Congress, members of the House, for the first time in its history, took turns reading the Constitution aloud. But here too the voices of the voters who demanded a return to constitutional principles would soon be ignored, especially in the Senate. Yet the principles endure, as does the Constitution itself. It is still the law of the land, however little followed. And the implications of ignoring it have not changed either. Limited government is the foundation for liberty, prosperity, and the vision of equality that many Americans still cherish—to say nothing of millions around the world who are still inspired by the document.

To be sure, many members of Congress—and many Americans today as well—seem to believe that prosperity is brought about primarily by government programs, not by individuals acting in their private capacities in the private sector. And they believe, too, that the Constitution authorizes Congress to enact such programs. But there are many other Americans in this deeply divided country who know better. They understand that government rarely solves problems as promised; in fact, it usually makes

them worse. More important still, they understand that a life dependent on government is both impoverishing and impoverished. They want no part of such dependence. They want a life of independence. They yearn to be free.

Reducing Government

If we are to move toward restoring constitutionally limited government and the prosperity it encourages—toward a world in which government is no longer expected to solve our problems, but individuals, families, firms, and communities assume that responsibility, indeed, take up that challenge—the basic questions are how much to reduce and how fast to do it. Those are not questions about how to make government run better—waste, fraud, and abuse will ever afflict government—but about the fundamental role of government in America.

How Much to Reduce Government

The first of those questions—how much to reduce government—would seem initially to be a matter simply of policy: What do we want government to do and what can we remove from government's responsibility? Yet if we take the Constitution seriously, the Framers largely answered those questions. Indeed, they thought long and hard about the proper role of government. They drew on fundamental moral principles about individual liberty and set forth the broad policy outlines in the Constitution, expressly enumerating—and thus limiting—the powers of the federal government.

Thus, setting aside for the moment all practical concerns, the Constitution tells us as a matter of first principle how much to reduce government. It tells us, first, what powers the federal government in fact has and, second, how governments at all levels must exercise their powers—by respecting the rights of the people.

That means that if a federal power or program is not *authorized* by the Constitution, it is illegitimate. Given the present size and scope of government, that is a stark conclusion, to be sure. But it flows quite naturally from the Tenth Amendment, the final statement in the Bill of Rights, which says, "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." In a nutshell, the Constitution establishes a government of delegated, enumerated, and thus limited powers. As the *Federalist Papers* make clear, the Constitution was written not only to empower the federal government but to limit it as well.

Since the Progressive Era, however, the politics of government-as-problem-solver has dominated our public discourse. And since the New Deal constitutional revolution, following President Franklin Roosevelt's infamous Court-packing threat, the Supreme Court has abetted that view by standing the Constitution on its head, turning it into a document of effectively unenumerated and hence unlimited powers.

Indeed, limits on government today, when we've had them, have come largely from political and budgetary rather than constitutional considerations. Thus, when government has failed to undertake a program in recent years, it has not been because of any perceived lack of constitutional authority but because of practical and political limits on the power of government to tax, borrow, and regulate. That is the mark of a parliamentary system, limited only by periodic elections, not of a limited, constitutional republic like we have.

The Founders could have established such a system, of course. They did not. But we have allowed those marks of a parliamentary system to supplant the system they gave us. To begin restoring truly limited government, therefore, we have to do more than define the issues as political or budgetary. We have to go to the heart of the matter and raise the underlying *constitutional* questions. We have to ask the most fundamental question: Does the government have the *authority*, the *constitutional* authority, to do what it is doing?

How Fast to Reduce Government

But as a practical matter, before Congress or the courts can relimit government as the Constitution requires, they need to take seriously the problems posed by both the present state of public opinion on the subject and, even more, individual dependence on public programs. After all, a substantial number of Americans—to say nothing of the institutions that influence public opinion—have little appreciation for or even apprehension of the constitutional limits on activist government.

Thus, in addressing the question of how fast to reduce government, we have to recognize that the Supreme Court, after nearly 80 years of arguing otherwise, is hardly in a position, by itself, to relimit government in the far-reaching way a properly read and applied Constitution requires. Nor does Congress, at this point, have sufficient moral authority or support to end tomorrow the vast array of programs it has enacted over the years—even if it wanted to. Worse still, millions of Americans have become dependent on those programs. For that reason alone, Congress will have

to move slowly and carefully, balancing long-term goals with short-term necessities.

For either Congress or the Court to be able to do fully what should be done, therefore, a proper foundation must first be laid. At bottom, public opinion must evolve such that a sufficiently large portion of Americans support the changes needed. When enough people come forward to ask—indeed, to demand—that government limit itself to its constitutional powers, thereby freeing individuals, families, firms, and communities to solve their own problems, we will know we are on the right track. In that regard, one can only be encouraged by the handmade signs seen in the early, massive tea-party rallies in recent years that said, "We want less!" There is an untapped reservoir of support in America for less government and genuine independence.

Just how deep or wide that reservoir is remains to be seen, of course. Certainly, the debate today is different than it was in the 1960s and 1970s, when proposals for "national economic planning" could be introduced in Congress without embarrassment. And Americans have seen what happens in other countries when governments tax, spend, and regulate without restraint. Still, a good deal more must be done before Congress and the courts are able to move very far in the right direction. We are a long way from restoring constitutional government in America. To move the process along, Congress should take the lead in the following ways.

Engaging in Constitutional Debate in Congress and in Public Discussions

For much of America's early history the Constitution played a prominent role in our political discourse. Members of Congress and presidents actively debated whether proposed measures were consistent with the Constitution. They did not, as often happens today, simply assume that they had the authority to introduce a given bill, pass it, and then leave it to the courts to determine its constitutionality. Nor did presidents make a practice of ruling by executive fiat and then arrogantly saying to those who took exception, "So sue me." They took seriously their oaths to uphold the Constitution. That sense of moral and constitutional responsibility needs to be revived.

As noted above, it *was* revived, briefly, by a number of House freshmen in the 104th Congress. Those representatives created an informal Constitutional Caucus to encourage constitutional debate in Congress and the nation and, in time, to begin restoring constitutional government. The

caucus needs to be revived, along with the spirit behind it, and its work needs to be expanded.

By itself, of course, neither the caucus nor the entire Congress can solve the problems before us. To be sure, in principle, and in a reversal of all human experience, Congress in a day could agree to limit itself to its enumerated powers and then roll back the countless programs it has enacted by exceeding its constitutional authority. But authoritative opinions from the Supreme Court would be needed to reverse a substantial body of largely post–New Deal decisions and embed those restraints in "constitutional law"—even if they have been embedded in the *Constitution* from the outset, the Court's modern readings of the document notwithstanding.

The Goals of the Constitutional Caucus

The *ultimate* goal of the caucus and Congress, then, should be to encourage the Court to reach such decisions. Despite the distinction between politics and law, history teaches that the Court does not operate entirely in a vacuum. To some degree, public opinion is the precursor and seedbed of its decisions. Thus, the more immediate goal of the caucus should be to influence the debate in the nation by influencing the debate in Congress. To do that, it is not necessary or even desirable, in the present climate, that every member of Congress be a member of the caucus, however worthy that end might be. But it *is* necessary that those who join the caucus be committed to its basic ends. And it is necessary that members establish a clear agenda for reaching those ends.

Here is the problem in a nutshell: every day, members of Congress are besieged by requests to enact countless measures to solve endless problems. Indeed, listening to much of the recent campaign debate, one might conclude that no problem is too personal or too trivial to warrant the attention of the *federal* government no less. Yet most of the "problems" Congress spends most of its time addressing—from health care to day care, education, housing, economic competition, and so much more—are simply the personal and economic problems of life that individuals, families, and firms, not governments, should be addressing. What is more, as a basic point of constitutional doctrine, under a constitution like ours, interpreted as ours was meant to be interpreted, there is little authority for government at any level to address such problems.

Properly understood and used, then, the Constitution can be a valuable ally in the efforts of the caucus and Congress to reduce the size and scope of government. For in the minds and hearts of most Americans, it remains

a revered document, however little it may be understood by a substantial number of them. Thus, a central purpose of congressional debate should be to bring about a better understanding of our basic legal document and to restore the idea in the minds of the people that the Constitution does not authorize the kind of government we have today. In particular, importuning constituents need to be told, "I have no authority to do what you want me to do."

The Constitutional Vision

If the Constitution is to be so used, however, the main misunderstanding that surrounds it today must be recognized and candidly addressed. That misunderstanding is that the Constitution, without further amendment, is an infinitely elastic document that allows government to grow to meet public demands of whatever kind. Americans must come to see that the Founders, who were keenly aware of the expansive tendencies of government, wrote the Constitution precisely to check that kind of thinking and that possibility. To be sure, they meant for government to be our servant, not our master. But they meant it to serve us in a very limited way—by securing our rights, as the Declaration of Independence says, and by doing those few other things that government does best, as spelled out expressly in the Constitution.

In all else, we were meant to be free—to plan and live our own lives, to solve our own problems. That is what freedom is all about. Some may characterize that vision as tantamount to saying, "You're on your own." But that kind of response simply misses the point. In America, individuals, families, and organizations have never been "on their own" in the most important sense. They have always been members of communities, of civil society, where they could live their lives and solve their problems by following a few simple rules about individual initiative and responsibility, respect for property and promise, and charity toward the few who need help from others. Massive government planning and programs have upset that natural order—less so in America than elsewhere, but deeply here all the same.

Those are the issues that need to be discussed, in both human and constitutional terms. As a people, we need to rethink our relationship to government. We need to ask not what our government can do for us, but what we can do for ourselves and, where necessary, for others—not through government but apart from government, as private citizens and organizations. That is what the Constitution was written to enable. It

empowers government in a very limited way. It empowers people—by leaving us free—in every other way.

To proclaim and eventually secure that vision of a free people, the Constitutional Caucus should reconstitute itself and rededicate itself to that end at the beginning of the 115th Congress and the beginning of every Congress thereafter. The caucus should be both of and above Congress—as the constitutional conscience of Congress. Every member of Congress, before taking office, swears to support the Constitution. Today that's hardly a constraining oath, given the modern Court's open-ended reading of the document. Members of the caucus should dedicate themselves to the deeper meaning of that oath. They should support the Constitution the Framers gave us, as amended by subsequent generations, not as "amended" by the Court's expansive interpretations.

Encouraging Debate

Acting together, the members of the caucus could have a major impact on the course of public debate in this nation—not least by virtue of their numbers. What is more, there is political safety in those numbers. As Benjamin Franklin might have said, no single member of Congress can likely undertake the task of restoring constitutional government on his own; in the present climate, he would surely be hanged, politically, for doing so. But if the caucus hangs together, the task will be more bearable and enjoyable—and a propitious outcome more likely over time.

On the caucus agenda, then, should be those specific undertakings that will best stir debate and thereby move the climate of opinion. Drawn together by shared understandings, and unrestrained by the need for serious compromise, the members of the caucus are free to chart a principled course and employ principled means, which they should do.

They might begin, for example, by surveying opportunities for constitutional debate in Congress, then make plans to seize those opportunities. Clearly, when new bills are introduced, or old ones are up for reauthorization, an opportunity is presented to debate constitutional questions. But even before that, when plans are discussed in party sessions, members should raise constitutional issues. To get things going, the caucus might study the costs and benefits of eliminating clearly unconstitutional programs, the better to determine which can be eliminated most easily and quickly.

Above all, the caucus should look for strategic opportunities to employ constitutional arguments. Too often, members of Congress fail to appreci-

ate that if they take a principled stand against a seemingly popular program—and state their case well—they can seize the moral high ground and ultimately prevail over those who are seen in the end to be more politically craven.

All of that will stir constitutional debate—which is just the point. For too long in Congress that debate has been dead, replaced by the often dreary budget debate. America was not established by men with green eyeshades. It was established by men who understood the basic character of government and the basic right to be free. Debate centered on the Constitution needs to be revived. It needs to be heard not simply in the courts—where it is twisted through modern "constitutional law"—but in Congress as well.

Consulting the Constitution for Proper Authority and Debating That Point in Congress

It would hardly seem necessary to ask Congress, before it enacts any measure, to cite its constitutional authority for doing so. After all, is that not part of what it means to carry out, as a member of Congress, one's oath to support the Constitution? And if Congress's powers are limited by virtue of being enumerated, then presumably there are many things Congress has no authority to do, however worthy those things might otherwise be. Yet so far have we strayed from constitutional thinking that such a requirement today is treated perfunctorily—when it is not ignored altogether.

The most common perfunctory citations—usually captured in constitutional boilerplate—are to the General Welfare, Commerce, and Necessary and Proper Clauses of the Constitution. It is no small irony that those clauses were written not only as grants of power but also as shields against overweening government; yet today they are simply swords of federal power.

The General Welfare Clause

The first of Congress's 18 enumerated powers in Article I, Section 8, is the power to tax (and, by implication, spend) "to pay the debts and provide for the common defense and general welfare of the United States." In *Federalist* No. 41 and elsewhere, Madison argued, as did Jefferson and others, that the General Welfare Clause was meant to serve as a brake on Congress's power to tax and spend in furtherance of its *other* enumerated

powers or ends, all of which, he said, were subsumed under "the general welfare." Taxing and spending pursuant to those ends had to serve the *general* welfare, not the welfare of particular parties or sections of the country. Madison's view contrasted sharply with that of Hamilton, who believed that Congress had an *independent* power to tax and spend *for the general welfare*.

The problem with Hamilton's view was stated clearly in 1828 by South Carolina's William Drayton. Rising on the floor of the House, he said that it would undermine the very centerpiece of the Constitution, the doctrine of enumerated powers, rendering Congress's 17 other powers superfluous. Since money can accomplish anything, he continued, whenever Congress wanted to do something it was barred from doing because given no power with which to do it, it could simply declare the act to be serving "the general welfare" and thus escape the limits imposed by enumeration. Indeed, he concluded, what was the point of enumerating Congress's other powers if it could do whatever it wanted under this sole power?

Unfortunately, in 1936, in dicta and almost in passing, the Supreme Court revisited this early debate and came down, as a practical matter, on Hamilton's side, declaring that there is an *independent* power to tax and spend for the general welfare, albeit limited by the word "general." Then, in 1937, in upholding the constitutionality of the new Social Security scheme, the Court completed the job when it stated the Hamiltonian view not as dicta but as doctrine. But while it reminded Congress of the constraint imposed by the word "general," the Court added that it would not itself police that restraint but would leave it to Congress to police itself—the very Congress that was distributing money from the Treasury with ever greater particularity. Since that time, the relatively modest redistributive schemes that preceded the New Deal have grown exponentially until today they are everywhere.

In truth, textualists must grant that this was not the most artfully written part of our Constitution. Not surprisingly, Congress, to say nothing of the courts, often found the line it draws difficult to discern and apply even before the New Deal Congresses effectively ended fiscal discipline. Yet, a middle ground between Madison and Hamilton can be found if we focus on the power of Congress to tax and spend for the *general* welfare *of the United States*, as was done during most of the pre–New Deal era, albeit less as time went on. That interpretation would allow for spending on, among other things, limited infrastructure and certain "public goods"

as economists define that idea, citing free-rider problems, nonexcludability, and nonrivalrous consumption.

But owing to the imprecision of this clause, it falls rather more to Congress than to the courts to exercise the discipline that is necessary to preserve the Constitution's overall structure for limited government. Congress needs to rediscover that discipline. Indeed, this is quintessentially an area where *Congress* needs to take the lead in debating the virtues of limited constitutional government as a *political* matter rather than leaving it to the courts to find lines that are difficult to find as a *legal* matter.

The Commerce Clause

The Commerce Clause of the Constitution, which grants Congress the power to regulate "commerce among the states," was also written primarily as a shield—in this case against overweening *state* power. Under the Articles of Confederation, to protect local merchants and manufacturers from out-of-state competitors, states had erected tariffs and other protectionist measures that impeded the free flow of commerce among the states. In fact, the need to break the logjam that resulted was one of the principal reasons for the call for a convention in Philadelphia in 1787. To address the problem, the Framers gave Congress the power to regulate—or "make regular"—commerce among the states. It was meant primarily as a power to facilitate free trade. And it was so used in 1824 in the first great Commerce Clause case, *Gibbons v. Ogden*.

That functional account of Congress's commerce power is consistent with the original understanding of the power, the text of the clause (especially the original meaning of "regulate"), and the structural limits entailed by the doctrine of enumerated powers. Yet today, following decisions by the Court in 1937, 1942, and beyond, Congress is able to regulate anything that even "affects" interstate commerce, which in principle is everything. Far from ensuring the free flow of commerce among the states, much of that regulation, for all manner of social and economic purposes, actually frustrates the free flow of commerce. In effect, the commerce power has become a general police power of a kind that the Framers reserved to the states.

The Necessary and Proper Clause

Congress often exercises those redistributive and regulatory powers through the last of its 18 enumerated powers, its power "to make all

laws which shall be necessary and proper for carrying into execution the foregoing powers." Thus, the Necessary and Proper Clause affords Congress *instrumental* powers: it provides Congress the *means* for executing its other powers or pursuing its other enumerated ends. As such, therefore, it is not an independent power; rather, the means it affords Congress are limited by those other enumerated powers or ends—limited simply to carrying them into execution. Moreover, not any such instrumental powers will do: they must be both necessary for that purpose and proper—"proper" in respecting the other branches, the sovereignty of the states, and the rights of the people.

Just as the explosive growth of the modern redistributive state has taken place almost entirely under the General Welfare Clause, so has the growth of the modern regulatory state taken place almost entirely under the Commerce Clause—as complemented by the Necessary and Proper Clause in both cases. That raises the fundamental question that Drayton raised above, which members of Congress need to keep in mind: If the Framers had meant for Congress to be able to do virtually anything it wanted under just those three clauses, why did they bother to enumerate Congress's other powers, or defend the doctrine of enumerated powers throughout the *Federalist Papers*? Those efforts would have been pointless.

Lopez *and Its Aftermath: A Case Study in Congressional Indifference*

Today, as noted above, congressional citations to the General Welfare, Commerce, and Necessary and Proper Clauses usually take the form of perfunctory boilerplate. When it wants to regulate some activity, for example, Congress makes a bow to the doctrine of enumerated powers by claiming that it has made findings that the activity at issue "affects" interstate commerce—say, by preventing interstate travel. Given those findings, Congress then claims it has authority to regulate the activity under its power to regulate commerce among the states.

Thus, when the 104th Congress was pressed in the summer of 1996 to do something about what looked at the time like a wave of church arsons in the South, it sought to broaden the already dubious authority of the federal government to prosecute such acts by determining that church arsons "hinder interstate commerce" and "impede individuals in moving interstate." Never mind that the prosecution of arson has traditionally been a state responsibility, there being no general federal police power in the Constitution. Never mind that church arsons have virtually nothing to do with interstate commerce, much less with the free flow of goods

and services among the states. The Commerce Clause rationale, set forth in boilerplate language, was thought by Congress to be sufficient to enable it to move forward and enact the Church Arson Prevention Act of 1996—unanimously, no less.

Yet only a year earlier, in the celebrated *Lopez* case, the Supreme Court had declared, for the first time in nearly 60 years, that Congress's power under the Commerce Clause has limits. To be sure, the Court raised the bar against federal regulation only slightly: Congress would have to show that the activity it wanted to regulate "substantially" affected interstate commerce, leading Justice Clarence Thomas to note in his concurrence that the Court was still a good distance from a proper reading of the clause. Nevertheless, the decision was widely heralded as a shot across the bow of Congress. And many in that 104th Congress saw it as confirming at last their view that the body in which they served was simply out of control, constitutionally. Indeed, when it passed the Gun-Free School Zones Act of 1990—the statute at issue in *Lopez*—Congress had not even bothered to cite its authority under the Constitution, even in boilerplate. In what must surely be a stroke of consummate hubris—and disregard for the Constitution—Congress simply assumed that authority.

But as a mark of how quickly respect for constitutional principle evaporated even in that "radical" 104th Congress, despite the Court's 1995 *Lopez* ruling, Congress in 1996 passed the Gun-Free School Zones Act *again*! This time, however, the boilerplate was included in the form of a perfunctory "jurisdictional element," even as Sen. Fred Thompson of Tennessee reminded his colleagues from the floor of the Senate that the Supreme Court had recently told them that they "cannot just have some theoretical basis, some attenuated basis" under the Commerce Clause for such a statute. The prosecution of gun possession near schools, like the prosecution of church arsons, is very popular, of course, as state prosecutors well know. But governments can address problems only if they have authority to do so, not from good intentions alone. Indeed, the road to constitutional destruction is paved with good intentions.

Congressional debate on these matters is thus imperative: it is not enough for Congress simply to say the magic words—"General Welfare Clause," "Commerce Clause," "Necessary and Proper Clause"—to be home free, constitutionally. Not every debate will yield satisfying results, as the examples above illustrate. But if the Constitution is to be kept alive, there must at least be debate. Over time, good ideas tend to prevail over bad ideas, but only if they are given voice. The constitutional debate must

again be heard in the Congress of the United States as it was over much of our nation's history, and it must be heard before bills are introduced, much less enacted. The American people can hardly be expected to take the Constitution and its limits on government seriously if their elected representatives do not.

Restoring Constitutional Government by Carefully Returning Power Wrongly Taken from the States and the People

If Congress should enact no new legislation without grounding its authority to do so securely in the Constitution, so too should it begin repealing legislation not so grounded, legislation that arose by assuming power that rightly rests with the states or the people. To appreciate how daunting a task that will be, simply reflect again on Madison's observation that the powers of the federal government under the Constitution are "few and defined."

But the magnitude of the task is only one dimension of its difficulty. Let us be candid: there are many in Congress who will oppose any efforts to restore constitutional government for any number of reasons, ranging from the practical to the theoretical. Some see their job as one primarily of representing the interests of their constituents, especially the short-term interests reflected in the phrase "bringing home the bacon." Others simply like big government, whether because of an "enlightened" Progressive Era view of the world or because of a narrower, more cynical interest in the perquisites of enhanced power. Still others believe sincerely in a "living constitution," one extreme form of which—the "democratic" form—imposes no limits whatever on government save for those arising from periodic elections. Finally, there are those who understand the unconstitutional and hence illegitimate character of much of what government does today but believe it is too late to do anything about it. All of those people and others will find reasons to resist the discrete measures that are necessary to begin restoring constitutional government. Where necessary, their views will have to be accommodated as the process unfolds.

Maintaining Support for Limited Government

Given the magnitude of the problem, and the practical implications of repealing federal programs, a fair measure of caution is in order. As the nations of Eastern Europe and the former Soviet Union learned, it is relatively easy to get into socialism—just seize all property and labor and

place it under state control—but much harder to get out of it. It is not simply a matter of returning what was taken, for much changed as a result of the taking. People have died and new people have come along. Public law has replaced private law. And new expectations and dependencies have arisen and become settled over time. The transition to freedom that many of those nations have experienced, to one degree or another, is what we and many other nations around the world today are facing, to a lesser extent, if we too try to reduce the size and scope of our governments.

As programs are reduced or eliminated, then, care must be taken to do as little harm as possible—for two reasons at least. First, there is a sense in which the federal government today, vastly overextended though it is, stands in a contractual relationship with the American people. That idea is very difficult to pin down, however, for once the real contract—the Constitution—has broken down, the "legislative contracts" that arise to take its place invariably come down to programs under which some people have become dependent upon others, although neither side had much say in the matter at the outset. Whatever its merits, that contractual view is held by a goodly portion of the public, especially regarding so-called middle-class entitlements.

That leads to the second reason why care must be taken in restoring power to the states and the people, namely, that the task must be undertaken, as noted earlier, with the support of a substantial portion of the people—ideally, at the urging of those people. Given the difficulty of convincing people—including legislators—to act against their relatively short-term interests, it will take sound congressional judgment about where and when to move. More important, it will take keen leadership, leadership that is able to frame the issues in a way that will communicate both the rightness and the soundness of the decisions that are required.

In exercising that leadership, there is no substitute for staying on message and keeping the message simple, direct, and clear. The aim, again, is both freedom and prosperity. We need to appreciate how the vast government programs we have created over the years have actually reduced the freedom and well-being of all of us—and have undermined the Constitution besides. Not that the ends served by those programs are unworthy—few government programs are undertaken for worthless ends. But individuals, families, private firms, and communities could bring about most of those ends voluntarily and at far less cost if only they were free to do so—especially if they were free to keep the wherewithal that is necessary to do so rather than give it to governmental redistributors. If individual freedom and

individual responsibility are values we cherish—indeed, are the foundations of a good society—we must come to appreciate how our massive government programs have undermined those values and, with that, the good society itself.

Redistributive Programs

Examples of the kinds of programs that should be returned to the states and the people are detailed elsewhere in this *Handbook*, but a few warrant mention here. Without question, the most important example of devolution to come from the "radical" 104th Congress was in the area of welfare. However flawed the final legislation that President Clinton signed in 1996 may have been from both a constitutional and a policy perspective, it was still a step in the right direction. Ultimately, as discussed more generally below, welfare should not even be a state program. Rather, it should be a matter of private responsibility, as it long was in America. But the process of getting the government out of the business of charity—and the federal government especially, for the Constitution grants it no such authority—was at least begun in the 104th Congress.

Eventually, that process should be repeated in every other "entitlement" area, from individual to institutional to corporate, from Social Security and Medicare to the National Endowment for the Arts to the Department of Agriculture's Market Access Program, and on and on. One assumes that each of those programs was started for a good reason, yet each involves taking from some and giving to others—policies that are both wrong and unconstitutional, to say nothing of monumentally inefficient. Taken together, they put us all on welfare in one way or another, and we are all the poorer for it.

Some of those programs will be harder to reduce, phase out, or eliminate than others, of course. Entitlement programs with large numbers of beneficiaries, for example, will require transition phases to minimize harm and maintain public support. Other programs, however, could be eliminated with relatively little harm. Does anyone seriously doubt that there would be art in America without the National Endowment for the Arts (NEA)? Indeed, without the heavy hand of government grantmaking, the arts would likely flourish as they did long before the advent of the NEA—and critics would not be made to pay, through their taxes, for art they abhor.

In fact, it is the transfer programs in "symbolic" areas that may be the most important to eliminate first since they have multiplier effects reaching well beyond their raw numbers, and those effects are hardly neutral on

the question of reducing the size and scope of government. As a matter of principle, does anyone seriously believe there is any constitutional authority whatever for the National Endowment for the Arts, the National Endowment for the Humanities, the Corporation for Public Broadcasting, or the Department of Education? Yet each raises concerns about free speech—to say nothing of their potential for undermining the cause of limiting government. Not a few critics have pointed to the heavy hand of government in those symbolic areas. And of equal importance is the problem of compelled speech. As Jefferson wrote, "To compel a man to furnish contributions of money for the propagation of opinions which he disbelieves is sinful and tyrannical." But on a more practical note, if Congress is serious about addressing the climate of opinion in the nation, it will end such programs not simply because they rest on no constitutional authority but because they have demonstrated a relentless tendency toward propagating ever more government. Indeed, one can hardly expect those institutions to underwrite programs that advocate less government when they themselves exist through government.

Regulatory Redistribution

If the redistributive programs that constitute the modern welfare state are candidates for elimination, so too are many of the regulatory programs that have arisen under the Commerce Clause. Here, however, care must be taken not simply from a practical perspective but from a constitutional perspective as well, for some of those programs may be constitutionally justified. When read functionally, recall, the Commerce Clause was meant to enable Congress to ensure that commerce among the states is regular, and especially to counter state actions that might upset that regularity. Think of the Commerce Clause as an early North American free trade agreement, without the heavy hand of "managed trade" that often accompanies the modern counterpart.

Thus conceived, the Commerce Clause clearly empowers Congress, through regulation, to override state measures that may frustrate the free flow of commerce among the states. But it also enables Congress to take such affirmative measures as may be necessary and proper to facilitate free trade, such as clarifying rights of trade in uncertain contexts or regulating the interstate transportation of dangerous goods. What the clause does not authorize, however, is regulation for reasons much beyond ensuring the free flow of commerce—the kind of managed trade, for example, that

is little more than a thinly disguised transfer program designed to benefit one party at the expense of another, picking winners and losers.

Unfortunately, most modern federal regulation falls into that final category, whether it concerns employment or health care, insurance, banking, or whatever. In fact, given budgetary constraints on the ability of government to tax and spend—to take money from some, run it through the Treasury, and then give it to others—the preferred form of transfer today is through regulation. That puts it "off budget." Thus, when an employer, an insurer, a lender, or a landlord is required by regulation to do something he would otherwise have a right not to do, or not do something he would otherwise have a right to do, he serves the party benefited by that regulation every bit as much as if he were taxed to do so, but no tax increase is ever registered on any public record. The temptation for Congress to resort to such "cost-free" regulatory redistribution is of course substantial, and the effects are both far reaching and perverse. Natural markets are upset as incentives are changed; economies of scale are skewed as large businesses, better able to absorb the regulatory burdens, are advantaged over small ones; defensive measures, inefficient from the broader perspective, are encouraged; and general uncertainty, anathema to efficient markets, is the order of the day. Far from facilitating free trade—the commerce power's basic purpose—redistributive regulation frustrates it. Far from being justified by the Commerce Clause, it undermines the very purpose of the clause.

Federal Crimes

In addition to misusing the commerce power for the purpose of regulatory redistribution, Congress has also misused it to create federal crimes. Thus, a great deal of regulation has arisen under the commerce power that is nothing but a disguised exercise of a general police power that Congress otherwise lacks. As noted earlier, the Gun-Free School Zones Act and the Church Arson Prevention Act are examples of legislation passed nominally under the power of Congress to regulate commerce among the states; but the actions subject to federal prosecution under those statutes—gun possession and church arson, respectively—are properly regulated under a *state's* general police power, the power of states to "police" or secure our rights. There is no federal power to criminalize such acts, except as an implication of federal sovereignty over federal territory or as may be necessary and proper for carrying into execution Congress's enumerated powers or ends.

The ruse of using the commerce power to criminalize acts that are the proper jurisdiction of the states should be candidly recognized. Indeed, it is a mark of the decline of respect for the Constitution's limits on federal power that when we fought a war on liquor early in the last century, we felt it necessary to do so by first amending the Constitution, there being no power otherwise for such a federal undertaking; but today, when we fight a war on drugs—with as much success as we enjoyed in the earlier war—we do so without so much as a nod to the Constitution.

The Constitution lists three federal crimes: treason, piracy, and counterfeiting. Today there are more than 3,000 federal crimes and perhaps 300,000 regulations that carry criminal sanctions. Over the years, no faction in Congress has been immune, especially in an election year, from the propensity to criminalize all manner of activities, utterly oblivious to the lack of constitutional authority for doing so. We should hardly imagine that the Founders fought a war to free us from a distant tyranny only to establish a tyranny in Washington, in some ways even more distant from the citizens it was meant to serve.

Policing the States

The federal government has not only intruded on the police power of the states, it has also failed in its responsibility under the Fourteenth Amendment to police the states. Here is an area where federal regulation has been, if anything, too restrained—yet, when undertaken, often unprincipled as well.

The Civil War Amendments changed America's federalism fundamentally and very much for the better, giving citizens an additional level of protection, not against federal but against state oppression—the oppression of slavery, obviously, but much else besides. Thus, the Fourteenth Amendment, ratified in 1868, begins by defining both federal and state citizenship, making it clear that the recently freed slaves were citizens of both the United States and the states wherein they resided. It then provides that "No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws." Those provisions of Section 1 are self-executing, which means that individuals can go straight into court to enforce them. And Section 5 gives Congress the "power to enforce, by appropriate legislation, the provisions of this article."

Unfortunately, confusion surrounded the interpretation and enforcement of the Fourteenth Amendment almost from the start. As the debate over the adoption of the amendment makes clear, the Privileges or Immunities Clause was meant to be the principal source of substantive rights under it, and those rights were meant to include the rights of free people everywhere: property, contract, personal security—in short, our "natural liberties," as Blackstone had earlier understood "privileges or immunities" to mean. But in 1873, in the notorious *Slaughterhouse Cases,* a bitterly divided Supreme Court essentially eviscerated the Privileges or Immunities Clause. There followed, for nearly a century, the era of Jim Crow in the South and, for a period stretching to the present, a Fourteenth Amendment jurisprudence as contentious as it is confused.

Increasingly over the 20th century, especially in the second half, modern liberals urged that the amendment be used as it was meant to be used—against state oppression; but their uses were selective, often reflecting a political agenda. On one hand, they urged courts to recognize "rights" that are no part of the natural rights that inform the amendment; on the other hand, they ignored or denigrated rights that were meant to be protected, like property and contract rights. For their part, modern conservatives, partly in reaction, called for the amendment to be used far more narrowly than it was meant to be used—for fear that it might be misused, as it has been. To sort this confusion out, there is no better place to begin than with the text of the abandoned Privileges or Immunities Clause. (Judicial methodology will be discussed more fully below.)

Again, the clause says that no state shall abridge "the privileges or immunities *of citizens of the United States*." We need to know, then, what the privileges or immunities of U.S. citizens were. And for that, we turn to the prior text of the Constitution. So doing, we find the few rights mentioned in the original Constitution; the rights enumerated in the Bill of Rights, at least as those can be applied by the Privileges or Immunities Clause against the states; and the many unenumerated rights we "retained" pursuant to the doctrine of enumerated powers as recognized by the Ninth Amendment, as discussed earlier. When the Bill of Rights was ratified, those privileges or immunities, except as otherwise provided, were not held against the *states* because, in 1833, in *Barron v. Baltimore*, the Supreme Court held that the Bill of Rights applied only against the government that was created by the document to which it was appended, the Constitution. That changed, however, and changed radically once the Fourteenth Amendment was ratified. No longer could *states* abridge those constitutional rights.

That reading is perfectly consistent with the debates that surrounded not only the adoption of the Fourteenth Amendment but the prior enactment of the Civil Rights Act of 1866, which the amendment was meant to constitutionalize and which Congress reenacted in 1868, just after the amendment was ratified. All citizens, the Civil Rights Act said in part, "have the right to make and enforce contracts, to sue, be parties and give evidence; to inherit, purchase, lease, sell, hold, and convey real and personal property, and to full and equal benefit of all laws and proceedings for the security of persons and property." Such were some of the "privileges or immunities" the Fourteenth Amendment was meant to secure.

Clearly, those basic natural and common law rights, drawn from the classic Lockean, reason-based theory of rights, were meant to be protected first by ordinary *state* law. But just as clearly, states often violated them, either directly or by failing to secure them against private violations, which is why the Fourteenth Amendment was needed. And states continued to violate them even after the amendment was ratified. Now, however, invoking one's *constitutional* rights against one's own state, appeal could be made to the courts, under Section 1 of the amendment, or to Congress, under Section 5, as noted above.

But once the Supreme Court eviscerated the Privileges or Immunities Clause, Fourteenth Amendment jurisprudence took a wandering turn. With the clause no longer available, courts began deciding cases under the less substantive Due Process or Equal Protection Clauses. That led in time to opposing complaints: on one hand were charges, made mainly by modern conservatives, that a rudderless "substantive due process" encouraged judges to invent "rights" and thus override democratic majorities; on the other hand were charges, made mainly by modern liberals, that a narrow "procedural due process" encouraged judges to defer to democratic majorities that were overriding individual rights. As the debate played out over the second half of the 20th century, it became increasingly clear that the heart of the problem was the demise of the Privileges or Immunities Clause and, with it, the theory of rights that stood behind the clause. Yet neither side seemed willing to revive the clause, much less do the serious work of discovering its true content.

That stalemate gave rise to a group of *classical* liberals and libertarians and to a call for returning to first principles, not only those of our founding but those of our second founding as well, when the principles of the Declaration of Independence, including equal treatment, were incorporated at last into the Constitution. Classical liberals urged reviving not

only the doctrine of enumerated powers and the original understanding of the Ninth and Tenth Amendments but also the Privileges or Immunities Clause. Responding to objections from conservatives, we made it clear that that would give the courts and Congress no power to secure modern "entitlements," which are no part of the common law tradition of life, liberty, and property. Rather, the power to secure rights that would be revived would be limited by the rights to be secured. To be sure, that power reaches *intrastate* matters when states are violating the provisions of the Fourteenth Amendment. But that is exactly what the amendment was meant to do. And that is the fundamental issue that the *Slaughterhous*e majority failed to recognize.

Thus, if the facts had warranted it, something like the Church Arson Prevention Act of 1996, depending on its particulars, might have been authorized not on Commerce Clause but on Fourteenth Amendment grounds. If, for example, the facts had shown that arsons of white churches were being prosecuted by state officials whereas arsons of black churches were not, then we would have had a classic case involving the denial of the equal protection of the laws. With those findings, Congress would have had ample authority under Section 5 of the Fourteenth Amendment "to enforce, by appropriate legislation, the provisions of this article."

Unfortunately, in the final version of the act, Congress struck citations to the Fourteenth Amendment, choosing instead to rest its authority entirely on the Commerce Clause. Not only is that a misuse of the Commerce Clause, inviting further misuses in the future, but assuming the facts had warranted it, it is a failure to use the Fourteenth Amendment as it was meant to be used, inviting future failures. Again, the Fourteenth Amendment has been both underused and misused by both Congress and the courts. But that is no reason to ignore it. Rather, it is a reason to correct the errors and use it properly.

In its efforts to return power to the states and the people, then, Congress must be careful not to misunderstand its role in our federal system. Over the 20th century, Congress assumed vast powers that were never its to assume, powers that belong properly to the states and the people. Those need to be returned. But at the same time, Congress and the courts do have authority under the Fourteenth Amendment to ensure that citizens are free from *state* oppression—free from "grassroots tyranny." However much that authority may have been underused or overused, it is there to be used; and if it is properly used, objections by states about federal interference in their "internal affairs" are without merit.

Rejecting Judicial Nominees Who Do Not Appreciate That the Constitution Is a Document of Delegated, Enumerated, and Thus Limited Powers

There is a crucial difference between the Constitution and "constitutional law"—the body of Supreme Court decisions that have interpreted and applied the Constitution, correctly or not, as cases have come before the Court over the years. As noted earlier, Congress could restore constitutional government on its own initiative simply by restricting its actions in the future to those that are authorized by the Constitution and by repealing its past actions that were taken without such authority. But for those limits to become "constitutional law" they would have to be recognized as such by the Supreme Court, which essentially abandoned that view of limited government during the New Deal. Thus, for the Court to play its part in the job of restoring constitutional government—or returning to rule under the Constitution—it must recognize the mistakes it has made, especially following Roosevelt's Court-packing threat in 1937, and then rediscover "the Constitution"—a process it began, however tentatively, in its 1995 *Lopez* decision when Chief Justice William Rehnquist rested his opinion explicitly on "first principles."

Unfortunately, in its 2005 California medical marijuana decision, *Gonzales v. Raich*, the Court abandoned the principles it had articulated in *Lopez* (and had articulated more fully in its 2000 *Morrison* decision). But in its 2011 *NFIB v. Sibelius* decision, challenging Obamacare's individual mandate and Medicaid expansion, the Court returned to principle, at least insofar as it held that there are limits on Congress's commerce and spending powers. What those and several other related decisions portend for the future of constitutional restoration by the Court is thus uncertain. At the least, after nearly eight decades of effectively unlimited government, we can say that the idea of a government of constitutionally limited powers is back in play.

But apart from its own actions, Congress is not powerless to influence the Court in the direction of constitutional restoration. As vacancies arise on the Court and on lower courts, Congress has a substantial say about who sits there through its power of advise and consent. To exercise that power well, however, it must have a better grasp of the basic issues than it has shown in recent years during Senate confirmation hearings for nominees for the courts. In particular, the Senate's obsession with "judicial activism" and "judicial restraint," terms that in themselves are largely vacuous, only distracts it from the real issue: the nominee's philosophy

of government and conception of the Constitution. To appreciate those points more fully, a bit of background is in order.

From Powers to Rights

The most important matter to grasp is the fundamental change that took place in our constitutional jurisprudence during the New Deal and the implications of that change for the modern debate. For decades after the New Deal constitutional revolution, debate focused far more on rights than on powers, and not surprisingly since the 1937 Court effectively eviscerated the doctrine of enumerated powers. Thus, in Supreme Court confirmation hearings, Senators have sought primarily to learn about a nominee's views about what rights are "in" the Constitution. That is an important question, to be sure, but it must be addressed within a larger constitutional framework, and that is what has been missing too often from recent hearings.

Clearly, the American debate began with rights—with the protests that led eventually to the Declaration of Independence. In that seminal document, Jefferson made rights the centerpiece of the American vision: rights to life, liberty, and the pursuit of happiness, derived from a premise of moral equality, itself grounded in a higher or natural law discoverable by reason—all to be secured by a government of limited powers made legitimate through consent.

But when they met again 11 years later to draft a constitution, the Framers focused on *powers*, not rights, and for two main reasons. First, their initial task was to create and empower a stronger government than had been authorized by the Articles of Confederation, which the Constitution did once it was ratified. But their second task, of equal importance, was to limit that government. And for that, they had two main options. They could have listed a set of *rights* that the new government would be forbidden to violate. Or they could have limited the government's *powers* by enumerating them, then pitting one power against another through a system of checks and balances—the idea being that where there is no power there is, by implication, a right, belonging to the states or the people. They chose the second option, for they could hardly have enumerated all of our rights, but they *could* enumerate the new government's powers, which were meant from the outset to be, as Madison said, "few and defined." Thus, *the doctrine of enumerated powers* became our principal defense against overweening government.

Only later, during the course of ratification, did it become necessary to add a Bill of Rights—as a *secondary* defense. But in so doing, the Framers were still faced with a pair of objections that had been posed from the start. First, it was impossible to enumerate all of our rights, which in principle are infinite in number. Second, given that problem, the enumeration of only certain rights would be construed, by ordinary methods of legal construction, as denying the existence of others. To overcome those objections, therefore, the Framers wrote the Ninth Amendment: "The enumeration in the Constitution of certain rights shall not be construed to deny or disparage others retained by the people." Clearly, we cannot "retain" what we do not first have to be retained—the natural rights we were born with and did not give up when we authorized and instituted the government through ratification.

Constitutional Visions

Thus, with the Ninth Amendment making it clear that we have both enumerated and unenumerated rights, the Tenth Amendment making it clear that the federal government has only enumerated powers, and the Fourteenth Amendment later making our rights good against the states as well, what emerges is an altogether libertarian picture. Individuals, families, firms, and the infinite variety of institutions that constitute civil society are free to pursue happiness as they wish, in accord with whatever values they have, provided only that in the process they respect the equal rights of others to do the same; and governments are instituted to secure that liberty and do the few other things their constitutions make clear they are *authorized* and empowered by the people, through their constitutions, to do.

That picture is a far cry from the modern liberal's vision, rooted in the Progressive Era, which would empower government to manage all manner of economic affairs. But it is a far cry as well from the modern conservative's vision, which would empower government to manage a substantial range of personal affairs. Neither vision reflects the true constitutional scheme. Both camps want to use the Constitution to promote their own substantive agendas. Repeatedly, liberals invoke democratic power for ends that are nowhere authorized by our Constitution of limited powers; at other times they invoke "rights," especially redistributive "rights," that are no part of our unenumerated rights, requiring government programs that are nowhere authorized, while ignoring rights like property and freedom of contract that are plainly enumerated. But conservatives too rely largely on expansive

readings of democratic power that were never envisioned, thereby running roughshod over rights that were meant to be protected, especially unenumerated rights.

From Liberty to Democracy

The great change in constitutional vision took place during the New Deal when the idea that galvanized the Progressive Era—that the basic purpose of government is to solve what are mainly personal problems—was finally instituted in law, not with an opinion here and there as had already been happening, but systematically through several Supreme Court decisions that, taken together, amounted to a radical reinterpretation of the Constitution, standing it on its head.

As noted earlier, following President Roosevelt's 1937 Court-packing threat, the Court eviscerated our first line of defense, the doctrine of enumerated powers, with a pair of decisions that converted the shields contained in the General Welfare and Commerce Clauses into swords of power. Then, in 1938, a cowed Court undermined the second line of defense, our enumerated and unenumerated rights, when it declared that henceforth it would defer to the political branches and the states when their actions implicated "nonfundamental" rights like those associated with "ordinary commercial transactions"—property and contract rights, for example. Legislation implicating such rights would be given minimal scrutiny, the Court said in effect, which in practice amounted essentially to no scrutiny at all. By contrast, when legislation implicated "fundamental" rights like voting, speech, and, later, certain "personal" liberties, the Court would apply "strict scrutiny," rendering most such acts unconstitutional. Finally, in 1943, the Court jettisoned the nondelegation doctrine, grounded in the first word of the Constitution after the Preamble: "*All* legislative powers herein granted shall be vested in a Congress." That allowed Congress to delegate ever more of its legislative powers to the executive branch agencies it had been creating, which is where most of our law today is written in the form of regulations, rules, interpretations, and more, thus undermining a core constitutional principle, the separation of powers.

Through those decisions, the Constitution was transformed, without benefit of amendment, from a limited libertarian to an expansive majoritarian document. The floodgates were thus opened to majoritarian tyranny, which very quickly became special-interest tyranny, including "crony capitalism," as public choice economic theory demonstrates should be

expected. And that led in turn to claims from many quarters that rights were being violated by these programs. Thus, the Court, focusing now not on powers but on rights, would have to try to determine whether the rights being claimed were or were not "in" the Constitution—a question the Constitution had spoken to only indirectly, for the most part, through the now-discredited doctrine of enumerated powers. And if it found the rights in question, the Court would then have to determine whether they were "fundamental" rights, to be protected under "strict scrutiny," or only "nonfundamental" rights, which would be ignored if there were some "rational basis"—some *conceivable* reason—for the legislation that implicated them. Where in the Constitution is this judicial methodology to be found? Nowhere. The Court invented it from whole cloth to make the world safe for the New Deal's social engineering schemes.

Judicial "Activism" and "Restraint"

Thus, it is no accident that until very recently the modern debate focused on rights, not powers. With the doctrine of enumerated powers effectively dead and government's powers essentially unlimited, the main issue left for the Court to decide, apart from structural and related issues, was whether there might be any rights that would restrain that power and whether those rights are or are not "fundamental." In the post–New Deal era, both liberals and conservatives bought into this jurisprudence. As noted above, both camps believed that the Constitution gives a wide berth to democratic decisionmaking. Neither side any longer asked the first question, the fundamental *constitutional* question: Does Congress have *authority* to pursue this end? Instead, that authority was simply taken for granted. Congress takes a policy vote on whatever proposal is before it and leaves it to the courts to determine whether there are any "fundamental" rights that might restrict their power.

Modern liberals, addicted to government programs, urged the Court to be "restrained" in finding rights that might limit their redistributive and regulatory schemes, especially "second-class" rights like property and contract. At the same time, they asked the Court to be "active" in finding "rights" invented from whole cloth that served their political agenda.

But modern conservatives were often little better. Reacting to abuses by liberal judicial "activists," most conservatives called for judicial "restraint" across the board. Thus, if liberal programs ran roughshod over the rights of individuals to use their property or freely contract, the remedy, conservatives often said, was not for the Court to invoke the doctrine of enumerated

powers—that battle was lost during the New Deal—nor even to invoke the rights of property and contract that are plainly in the Constitution—that might encourage judicial activism—but to turn to the democratic process to overturn those programs. Oblivious to the fact that restraint in finding rights is tantamount to activism in finding powers, and ignoring the fact that it was the democratic process that gave us those programs in the first place, too many conservatives offered us a counsel of despair amounting to a denial of constitutional protection.

No one doubts that in recent decades the Court has discovered "rights" in the Constitution that are no part of either the enumerated or unenumerated rights that the document was meant to protect. But it is no answer to that problem to ask the Court to defer wholesale to the political branches, thereby encouraging it, by implication, to sanction unenumerated *powers* that are no part of the document either. Indeed, if the Tenth Amendment means anything, it means that there are no such powers. Again, if the Framers had wanted to establish a simple democracy, they could have. Instead, they established a limited, constitutional republic, a republic with islands of democratic power in a sea of liberty, not a sea of democratic power surrounding islands of liberty.

Thus, it is not the proper role of the Court to find rights that are no part of the enumerated or unenumerated rights meant to be protected by the Constitution, thereby frustrating authorized democratic decisions. But neither is it the proper role of the Court to refrain from determining if those democratic decisions are in fact authorized and, if they are, whether their implementation violates rights guaranteed by the Constitution, enumerated and unenumerated alike.

The role of the judge in our constitutional republic is thus profoundly important and often profoundly complex. "Activism" is no proper posture for a judge, but neither is "restraint." Judges must apply the Constitution to cases or controversies before them, neither making it up nor ignoring it. They must be actively *engaged* with the document and, especially, with its underlying principles. In particular, they must appreciate keenly that the Constitution is a document of delegated, enumerated, and thus limited powers. That will get the judge started on the question of what rights are protected by the document; for again, where there is no power, there is a right, belonging either to the states or to the people. Indeed, we should hardly imagine that, before the addition of the Bill of Rights, the Constitution failed to protect most rights simply because most were not "in" the document. But reviving the doctrine of enumerated powers is only part

of the task before the Court. Especially when assessing the character and scope of state police power—the basic power of government to secure our rights—judges and justices must have a deep understanding of the classical theory of rights that stands behind the Constitution if it is to be restored correctly.

Those are the two sides—powers and rights—that need to be examined in the course of Senate confirmation hearings for nominees for the courts of the United States. It is important to know a nominee's "judicial philosophy," to be sure. But it is more important still to know his or her philosophy of the Constitution, for in the end it is the Constitution that defines us as a nation.

If a nominee does not have a deep and thorough appreciation for the basic principles of the Constitution—for the doctrine of enumerated powers and for the classical theory of rights that underpins the Constitution—then his or her candidacy should be rejected. In recent years, Senate confirmation hearings have provided opportunities for constitutional debate throughout the nation. Those debates need to move from the ethereal and often arid realm of "constitutional law" to the real realm of the Constitution. They are extraordinary opportunities not simply for constitutional debate but for constitutional renewal.

Unfortunately, in recent Congresses, we have seen the debate move not from "constitutional law" to the Constitution but in the opposite direction—to raw politics. We have heard demands that judicial nominees pass "ideological litmus tests," for example, as if judges in their work were supposed to reflect popular views of one sort or another. That is tantamount to asking judges not to *apply* the law, which is what judging is all about, but to *make* the law according to those values, whatever the actual law may require, and to commit to doing so during the judicial confirmation process no less. The duty of a judge under the Constitution is to decide cases according to the law, not according to whatever values or ideology may be in fashion. For that, the only ideology that matters is that of the Constitution.

Conclusion

America is a democracy only in the most fundamental sense of that idea: authority, or legitimate power, rests ultimately with the people, as manifested through the Constitution. Having authorized that power, the people have no more right thereafter to tyrannize each other through majoritarian acts than government itself has to tyrannize the people. When

they constituted us as a nation by ratifying the Constitution and the amendments that have followed, our ancestors gave up only certain of their powers as enumerated in the document, leaving us otherwise free to live our lives as we wish. We have allowed those powers to expand beyond all moral and legal bounds—at the price of our liberty and our well-being. The time has come to start returning those powers to their proper bounds, to reclaim our liberty, and to enjoy the fruits that follow.

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16. Property Rights and the Constitution

Congress should

- enact legislation for guiding federal agencies and influencing courts that outlines the constitutional rights of property owners under the Fifth Amendment's Takings Clause;
- follow the traditional common law in defining "private property," "public use," and "just compensation";
- treat property taken through regulation the same as property taken through physical seizure; and
- provide a single forum in which property owners may seek injunctive relief and just compensation promptly.

America's Founders understood clearly that private property is the foundation not only of prosperity but of freedom itself. Thus, through the common law, state law, and the Constitution, they protected property rights—the rights of people to acquire, use, and dispose of property freely. With the growth of modern government, however, those rights have been seriously compromised. Unfortunately, the Supreme Court has yet to develop a principled, much less comprehensive, theory for remedying those violations. That failure has led to the birth of the property rights movement in state after state. It is time now for Congress to step in—to correct the federal government's own violations and to set out a standard that courts might notice as they adjudicate complaints about state violations.

The Constitution protects property rights through the Fifth and Fourteenth Amendments' Due Process Clauses and, more directly, through the Fifth Amendment's Takings Clause: "nor shall private property be taken for public use without just compensation." There are two basic ways

government can take property: (1) outright, by condemning the property and taking title; and (2) through regulations that take uses, leaving the title with the owner—so-called regulatory takings. In the first case, the title is all too often taken not for a public but for a private use; and rarely is the compensation received by the owner just. In the second case, the owner is often not compensated at all for his losses; and when he is, the compensation is again inadequate.

Over the past three decades, the Supreme Court has chipped away at the problem of uncompensated regulatory takings, requiring compensation in some cases; but its decisions were largely ad hoc, leaving most owners to bear the losses themselves. Thus, owners today can get compensation when the title is actually taken, as just noted; when the property is physically invaded by government order, either permanently or temporarily; when regulation for other than health or safety reasons takes all or nearly all of the value of the property; and when government attaches conditions to permits that are unreasonable, disproportionate, or unrelated to the purpose behind the permit requirement. But despite those modest advances, toward the end of its October 2004 term, the Court decided three property rights cases in which the owners had legitimate complaints, and in all three, the owners lost. One of those cases was *Kelo v. City of New London*, in which the city condemned Ms. Kelo's property only to transfer it to another private party that the city believed could make better use of it. In so doing, the Court simply brushed aside the "public use" restraint on the power of government to take private property. The upshot, however, was a public outcry across the nation and the introduction of reforms in over 40 states. But those reforms varied substantially, and nearly all leave unaddressed the far more common problem of regulatory takings.

At bottom, then, the Court has yet to develop a principled and comprehensive theory of property rights, much less a comprehensive solution to the problem of government takings. For that, Congress (or the Court) is going to have to turn to first principles, much as the old common law judges did. We need to begin, then, not with the public law of the Constitution as presently interpreted, but with the private law of property.

Property: The Foundation of All Rights

It is no accident that a nation conceived in liberty and dedicated to justice for all protects property rights. Property is the foundation of every right we have, including the right to be free. Every right claim, after all, is a claim to some thing—either a defensive claim to keep what one is

holding or an offensive claim to something someone else is holding. John Locke, the philosophical father of the American Revolution and the inspiration for Thomas Jefferson when he drafted the Declaration of Independence, stated the issue simply: "Lives, Liberties, and Estates, which I call by the general Name, *Property*." And James Madison, the principal author of the Constitution, echoed those thoughts when he wrote, "as a man is said to have a right to his property, he may be equally said to have a property in his rights."

Much moral and legal confusion would be avoided if we understood that all of our rights—all of the things to which we are "entitled"—can be reduced to property. That would enable us to separate genuine rights—things to which we hold title—from specious "rights"—things to which other people hold title, which we may want for ourselves. It was the genius of the old common law, grounded in reason and custom, that it grasped that point. And the common law judges understood a pair of corollaries as well: property, broadly conceived, separates one individual from another; and individuals are independent or free to the extent that they have sole or exclusive dominion over what they hold. Indeed, Americans go to work every day to acquire property just so they can be independent.

Legal Protection for Property Rights

It would be to no avail, however, if property, once acquired, could not be used and enjoyed—if rights of acquisition, enjoyment, and disposal were not legally protected. Thus, common law judges, charged with settling disputes between neighbors, drew on principles of reason, efficiency, and custom to craft a law of property that by and large respected the equal rights of all.

In a nutshell, the basic rights they recognized, beyond acquisition and disposal, were the right of sole dominion—variously described as a right to exclude others, a right against trespass, or a right of quiet enjoyment, which all can exercise equally at the same time and in the same respect—and the right of active use, at least to the point where such use violates the rights of others to quiet enjoyment. Just where that point is will vary with the facts, of course, and that is the business of courts to determine, although legislatures can draw the broad outlines. Given our modern permitting regime, however, the point to be noticed here is that the presumption of the common law was ordinarily on the side of free use. People were not required to obtain a permit before using their property, that is, just as people today are not required to obtain a permit before

speaking. Rather, the burden was on those who objected to a given use to show how it violated a right of theirs. That amounts to having to show that their neighbor's use takes something they own free and clear. If they failed in that, the use could continue.

Thus, the common law limits the right of free use only when a use encroaches on the property rights of others, as in the classic law of nuisance and risk. The implications of that limit should not go unnoticed, however, especially in the context of modern environmental protection. Indeed, the belief, common today, that property rights are opposed to environmental protection is so far from the case as to be just the opposite: the right against environmental degradation is a *property* right. Under common law, properly applied, people cannot use their property in ways that damage their neighbors' property—defined, again, as taking things those neighbors hold free and clear. Properly conceived and applied, then, property rights are self-limiting: they constitute a judicially crafted and enforced regulatory scheme in which rights of active use end when they encroach on the property rights of others.

The Police Power and the Power of Eminent Domain

But if the common law of property defines and protects *private* rights—the rights of owners with respect to each other—it also serves as a guide for the proper scope and limits of *public* law—defining the rights of owners and the public with respect to each other. For public law, at least at the federal level, flows from the Constitution; and the Constitution flows from the principles articulated in the Declaration of Independence; and those reflect, largely, the common law. The justification of public law begins, then, with our rights, as the Declaration makes clear. Government then follows, not to give us rights through positive law but to recognize and secure the rights we already have through natural law. Thus, to be morally legitimate, the powers of government must be derived from and consistent with those rights.

The two public powers most often at issue in the property rights context are the police power—the power of government mainly to secure rights—and the power of eminent domain—the power to take property for public use upon payment of just compensation, as set forth, by implication, in the Fifth Amendment's Takings Clause.

The general police power—the fundamental power of government—is derived from what Locke called the Executive Power, the power each of us has in the state of nature to secure our rights. Thus, *as such*, this

legal power is legitimate since it is nothing more than the public law version of a moral power we already have, by right, which we gave to government to exercise on our behalf when we constituted ourselves as a nation. But its *exercise* is legitimate only insofar as it is used to secure rights and to provide certain "public goods" like national defense and clean air—narrowly defined as economists do, citing free-rider problems, nonexcludability, and nonrivalrous consumption—and only insofar as its use respects the rights of others. Thus, while our rights give rise to the police power, they also limit it. We cannot use the police power for non-police-power purposes. It is a power mainly to secure rights through restraints or sanctions, not some general power to provide the public with goods and services more broadly defined.

A complication arises in the case of the federal government, however, because there is no general federal police power. Rather, the Constitution establishes a government of delegated, enumerated, and thus limited powers, leaving most powers, including the general police power, with the states or the people, as the Tenth Amendment makes clear. Consistent with constitutional principle, then, whatever power the federal government has to secure rights is limited to federal territory, is incidental to one of its enumerated powers, or is entailed mainly through the amendments. (See Chapter 15 for greater detail on this point.)

But if the police power is thus limited, then any effort to provide the public with goods and services more broadly must be accomplished under some other power, such as those, in the case of the federal government, that are enumerated in Article I, Section 8 of the Constitution. Yet that effort will be constrained by the Takings Clause, which requires that private property taken in pursuit of such ends—whether in whole or in part is irrelevant—must be accompanied by just compensation for the owner of the property. Otherwise the costs of the benefit to the public would fall entirely on the owner. Not to put too fine a point on it, that would amount to theft. Indeed, it was to prohibit that kind of thing that the Framers wrote the Takings Clause in the first place.

Thus, the power of eminent domain—which is not enumerated in the Constitution but is implicit in the Takings Clause—is an instrumental power: It affords a means that enables government, acting under some other power, to pursue other ends—building roads, for example, or saving wildlife. Moreover, unlike the police power, the eminent domain power is not inherently legitimate: Indeed, in a state of nature, prior to the creation of government, none of us would have a right to condemn a

neighbor's property, however worthy our purpose, however much we compensated him. Thus, it is not for nothing that eminent domain was known in the 17th and 18th centuries as "the despotic power." It arises from practical considerations alone—to enable public projects to go forward without being held hostage to holdouts seeking to exploit the situation by extracting far more than just compensation. As for its justification, the best that can be said for eminent domain is this: the power was ratified by those in the original position; and it is "Pareto superior," as economists say, meaning that at least one party (the public) is made better off by its use, as evidenced by its willingness to pay, while no one is made worse off, assuming the owner receives just compensation.

When Is Compensation Required?

We come then to the basic question: When do owners have to be compensated as a result of government actions? In general, there are four scenarios to consider.

First, when government actions incidentally reduce property values, but no rights are violated because nothing that belongs free and clear to the owner is taken, no compensation is due. If the government closes a military base or a neighborhood school, for example, or builds a new highway distant from the old one with its commercial enterprises, property values may decline as a result—but nothing was taken. We own our property and all the legitimate uses that go with it, not the value in our property, which is a function of many ever-changing factors.

Second, when government acts, under its police power, to secure rights—when it stops someone from polluting, for example, or from excessively endangering others—the restricted owner is not entitled to compensation, whatever his financial losses, because the uses prohibited or "taken" were wrong to begin with. Since there is no right to pollute, no right was taken. Thus, we do not have to pay polluters not to pollute. Here again the question is not whether *value* was taken but whether a *right* was taken. Proper uses of the police power take no rights. They *protect* rights.

Third, when government acts not to secure rights but to provide the public with goods like wildlife habitat, scenic views, or historic preservation, and in so doing prohibits or "takes" some otherwise *rightful* use, then it is acting, in part, under the eminent domain power and *does* have to compensate the owner for any losses he may suffer. The principle here is quite simple: the public has to pay for the goods it wants, just like any

private person would have to. Bad enough that the public can take what it wants by condemnation; at least it should pay for what it takes rather than ask the owner to bear the full cost of its appetite. It is here, of course, that modern regulatory takings abuses are most common, as governments at all levels try to provide the public with all manner of amenities, especially environmental amenities, "off budget." As noted above, there is an old-fashioned word for that practice—"theft"—and no amount of rationalization about "good reasons" will change that. Even thieves, after all, have "good reasons" for what they do.

Finally, when government, through full condemnation, takes for public use not simply some or all of the owner's uses but the entire estate, including the title, compensation is clearly due.

Some Implications of a Principled Approach

Starting from first principles, then, we see that there is no difference in principle between the full use of eminent domain just described and a regulatory taking—between taking full title and taking only uses. Thus, the oft-heard claim that the Takings Clause requires compensation only for "full" takings will not withstand scrutiny. Giving the clause a natural reading, it speaks simply of "private property." As Madison wrote (above), "property" denotes all the uses or rights that can rightly be made of a holding. It does not denote simply the underlying estate. In fact, in every area of property law except regulatory takings, we speak of property as being a "bundle of sticks," any one of which can be bought, sold, rented, bequeathed, what have you. Yet, to enable government to provide the public with goods "off budget" and thus "on the cheap," takings law has clung to the idea that only if the entire bundle is taken does government have to pay compensation.

That view enables government to extinguish nearly all uses through regulation—and hence to regulate nearly all value out of property—yet escape the compensation requirement because the all-but-empty title remains with the owner. And it would allow a government to take 90 percent of the value in year one, then come back a year later and take title for a dime on the dollar. Not only is that wrong, it is unconstitutional. It cannot be what the Takings Clause stands for. The principle, rather, is that property is indeed a bundle of sticks, a bundle of rights: take one of those sticks and you take something that belongs to the owner. The only question then is how much his loss is worth.

Thus, when the Court in 1992 in *Lucas v. South Carolina Coastal Council* crafted what is effectively a 100 percent rule, whereby owners are entitled to compensation only if regulations restrict uses to a point where *all* value is lost, it went about the matter backward. It measured the loss to determine whether there was a taking. As a matter of first principle, the Court should have determined first whether there was a taking—whether otherwise legitimate uses were prohibited by the regulation—and only then should it have measured the loss. That addresses the principle of the matter. It then remains simply to measure the loss in value and hence the compensation that is due. In *Lucas*, since all uses were effectively taken, full compensation was due. The place to start, in short, is with the first stick, not the last dollar. That is especially so since most regulatory takings take only some uses, thus reducing the value of the property by less than its full value.

More generally, the principled approach to takings requires that the Court have a basic understanding of the theory of the matter and a basic grasp of how to resolve conflicting claims about use in a way that respects the equal rights of all. That is hardly a daunting task, as the old common law judges demonstrated, although the application of those principles in particular cases can be complicated, to be sure. But in general, as already noted, the presumption is on the side of active use until some plaintiff demonstrates that such use takes the quiet enjoyment that is his by right (and the defendant's right as well). At that point the burden shifts to the defendant to justify his use: absent some defense like the prior consent of the plaintiff, the defendant may have to cease his use—or, if his activity is worth it, offer to buy an easement or buy out the plaintiff. Thus, a principled approach respects equal rights of quiet enjoyment—and hence environmental protection. But it also enables active uses to go forward—though not at the expense of private or public rights. Users can be as active as they wish, provided they handle the "externalities" they create in a way that respects the rights of others.

What Congress Should Do

As already noted, the application of these principles is often fact dependent and so is best done by courts. But until our courts, and the Supreme Court in particular, craft a more principled and systematic approach to takings, Congress can assist by drawing at least the broad outlines of such an approach as a guide both for the courts and, more directly, for federal agencies.

In this last connection, however, Congress should recognize that the regulatory takings problem begins with regulation. Doubtless the Founders did not anticipate the modern regulatory state, so they did not specify that regulatory takings are takings too and thus are subject to the Just Compensation Clause. They did not envision our obsession with regulating every human activity and our insistence that such activities—residential, business, what have you—take place only after a grant of official permission. In some areas of business today, we have almost reached the point at which everything that is not permitted is prohibited. That reverses our Founding principle: everything that is not prohibited is permitted—that is, "freely allowed," not allowed only after obtaining a government permit.

Homeowners, developers, farmers and ranchers, mining and timber companies, firms large and small, profit seeking and not for profit, all have horror stories about regulatory hurdles they confront when they want to do something, particularly with real property. Many of those regulations are legitimate, of course, especially if they aim, preemptively, at securing genuine rights. But many more are aimed at providing some citizens with benefits at the expense of other citizens. They take rights from some to benefit others. At the federal level, such transfers are not likely to find authorization under any enumerated power. But even if constitutionally authorized, they need to be undertaken in conformity with the Takings Clause. Some endangered species, to take a prominent modern example, may indeed be worth saving, even if the authority for doing so belongs to states, and even if the impetus comes from a relatively small group. We should not expect a few property owners to bear all the costs of that undertaking, however. If the public truly wants the habitat for such species left undisturbed, let it buy that habitat or, failing that, pay the costs to the relevant owners of leaving their property unused.

In general, then, Congress should review the many federal regulations affecting private property to determine which are and are not authorized by the Constitution. If not authorized, they should be rescinded, which would end quickly a large body of regulatory takings now in place. But if authorized under some constitutionally enumerated power of Congress, the costs now imposed on particular owners, for benefits conferred on the public generally, should be placed "on budget." Critics of doing that are often heard to say that if those goods did go on budget, we couldn't afford them. What they are really saying, of course, is that taxpayers would be unwilling to pay for all the things the critics want. Indeed, the great fear of those who oppose taking a principled approach to regulatory takings

is that once the public has to pay for the benefits it now receives "free," it will demand fewer of them. It should hardly surprise that when people have to pay for something they demand less of it.

It is sheer pretense, of course, to suppose that such benefits are now free, that they are not already being paid for. Isolated owners are paying for them, not the public. As a matter of simple justice, Congress needs to shift the burden to the public that is enjoying the benefits. Once we have an honest, public accounting, we will be in a better position to determine whether the benefits thus produced are worth the costs. Today, we have no idea about that because all the costs are hidden. When regulatory benefits are thus "free," the demand for them, as we see, is all but infinite.

But in addition to eliminating, reducing, or correcting its own regulatory takings—in addition to getting its own house in order—Congress needs to enact general legislation on the subject of takings that might help to restore respect for property rights and reorient the nation toward its own first principles. To that end, Congress should do the following.

Enact Legislation That Specifies the Constitutional Rights of Property Owners under the Fifth Amendment's Takings Clause

As already noted, legislation of the kind recommended here would be unnecessary if the courts were reading and applying the Takings Clause properly. Because they are not, it falls to Congress to step in. Still, there is a certain anomaly in asking Congress to do the job. Under our system, after all, the political branches and the states represent and pursue the interests of the people within the constraints established by the Constitution; and it falls to the courts, and the Supreme Court in particular, to ensure that those constraints are respected. To do that, the Court interprets and applies the Constitution as it decides cases brought before it—often *against* the political branches or a state when an owner seeks either to enjoin a government action on the ground that it violates his rights or to obtain compensation under the Takings Clause, or both. Thus, it is somewhat anomalous to ask or expect *Congress* to right wrongs that Congress itself may be perpetrating. Is not Congress, in carrying out the public's will, simply doing its job?

Yes, that is part of its job. But members of Congress swear to uphold the Constitution, which requires them to exercise *independent* judgment about the meaning of its terms. And in that connection, they need to recognize that we do not live in anything like a pure democracy. The

Constitution sets powerful and far-reaching restraints on the powers of all three branches of the federal government and, especially since ratification of the Civil War Amendments, on the states as well. Thus, the idea that Congress simply enacts whatever some transient majority of the population wants enacted, leaving it to the courts to determine the constitutionality of its acts, must be resisted. The oath of office is taken on behalf of the people, to be sure, but through and in conformity with the Constitution. Even if the courts fail to secure the liberties of the people, therefore, nothing in the Constitution prevents *Congress* from exercising the duties entailed by the oath of office. In fact, that oath *requires* Congress to step into the breach.

There is no guarantee, of course, that Congress will do a better job of interpreting the Constitution than the Court has done. In fact, given that Congress is one of the political branches and thus an "interested" party, it could very well do a worse job. That is why the Framers placed "the judicial Power"—entailing, presumably, the power ultimately to say what the law is—with the Court, the nonpolitical branch. But that is no reason for Congress to ignore its responsibility to make its judgment known, especially when the Court is clearly wrong, as it is here. Although nonpolitical in principle, the Court does not operate in a political vacuum—as it demonstrated in 1937, unfortunately, after Franklin Roosevelt's notorious Court-packing threat. If the Court can be persuaded to undo the centerpiece of the Constitution, the doctrine of enumerated powers, as it did after that extraordinary and unconscionable political interference, one imagines it can be persuaded *by Congress* to restore property rights to their proper constitutional status.

Thus, to start, Congress should revisit and rescind or correct legislation that results in uncompensated regulatory takings—and enact no such legislation in future. In addition, however, Congress should enact a more general statute that specifies the constitutional rights of property owners under the Fifth Amendment's Takings Clause, drawing on common law principles to do so.

Follow the Traditional Common Law in Defining "Private Property," "Public Use," and "Just Compensation"

As we saw above, property rights are not protected by the Fifth Amendment's Takings Clause alone—that is, by positive constitutional law. Indeed, during the more than two years between the time the Constitution was ratified and took effect and the time the Bill of Rights was ratified,

it was the common law that protected property rights against both private and public invasion. Thus, the Takings Clause simply made explicit, against the new federal government, the guarantees that were already recognized under the common law. (Constitutional protection was *implicit* during that time, of course, through the doctrine of enumerated powers, for no uncompensated takings were authorized under the new Constitution.) And with the ratification of the Civil War Amendments—the Fourteenth Amendment's Privileges or Immunities Clause, in particular—the common law guarantees against the states were constitutionalized as well. Thus, because the Takings Clause takes its inspiration and meaning from the common law of property, it is there that we must look to understand its terms.

"Private property." The first of those terms is "private property": "nor shall private property be taken for public use without just compensation." As every first-year law student learns, "private property" means far more than a parcel of real estate. Were that not the case, property law would indeed be an impoverished subject. Instead, the common law reveals the many significations of the concept "property" and the rich variety of arrangements that human imagination and enterprise have made of the basic idea of private ownership. As outlined above, however, those arrangements all come down to three basic ideas—acquisition, exclusive use, and disposal, the three basic rights we have in property, from which more specifically described rights may be derived.

With regard to regulatory takings, however, the crucial thing to notice is that, absent contractual arrangements to the contrary, the right to acquire and hold property entails the right to *use* it as well. As Madison wrote, people have "a property" in their rights, including in their rights of use. If the right to property did not entail rights of use, it would be an empty promise. People acquire property, after all, only because doing so enables them to use it, which is what gives it its value. Indeed, the fundamental complaint about uncompensated regulatory takings is that, by thus eliminating some or all of the uses owners may make of their property, government makes the title they retain that much less valuable—even worthless in extreme cases. Who would buy property that cannot be used?

The very concept of "property," therefore, entails and denotes all the legitimate uses that can be made of the underlying estate, giving it value. And the uses that are legitimate are those that can be exercised consistent with the rights of others, private and public alike, as defined by the

traditional common law. As outlined above, however, the rights of others that limit an owner's uses depend often on the facts. Thus, legislation can state only the principle of the matter, not its application in specific contexts. Still, the broad outlines should be made clear in any congressional enactment. In particular, the term "private property" should be defined to include all the uses that can be made of property consistent with the common law rights of others. The only grounds that justify restricting uses without compensation are (1) to protect the rights of others; and (2) to provide narrowly defined "public goods," where owners receive public benefits equivalent to the losses incurred by regulation. By contrast, when a particular owner's uses are restricted to provide the general public with goods more broadly defined, the resulting loss in value should be compensated.

"Public use." Turning now from regulatory takings to the full use of eminent domain, here the government condemns the entire property and takes title in order to give the property a "public use"— a military base, for example, or a public school or highway. Unfortunately, governments today too often use eminent domain for much broader purposes, and courts have sanctioned such condemnations by reading "public *use*" as "public *benefit*." That has led to private-public collusion against private rights as governments condemn private property for the benefit of other private users, either directly or by delegating their condemnation power to a quasi-public or even a private entity. Those are rank abuses of the eminent domain power, amounting often to implicit grants of private eminent domain and to invitations to public graft and corruption. Typically, when a large private entity wants to expand, it goes to the relevant public agency and asks that a nearby property be condemned and title transferred to it, arguing that the expansion will benefit the public through increased jobs, business, taxes, what have you. No longer needing to bargain with the owners of the target properties in an effort to buy them, the entity simply asks or even pays the agency to condemn the properties "for the public good."

Because eminent domain is a "despotic power," it should be used rarely and only for genuinely *public* uses. That means uses that are broadly enjoyed by the public, rather than by some narrow part of the public; and in the case of the federal government, it means a constitutionally authorized use. In defining "public use," however, facts matter, and sometimes there is no bright line. Nevertheless, certain general considerations

can be noted. To begin, if the compensation is just, then no problem arises when title is transferred to the public for a genuine public use such as those mentioned above. Nor is there a problem when title is transferred to a *private* party—for example, to avoid the holdout situation that might arise with laying cable or telephone lines—provided the subsequent use is open to all on a nondiscriminatory basis, often to be regulated in the public interest. In such cases, were eminent domain available only when the public kept the title, the public would be deprived of the relative efficiencies of private ownership.

Beyond such cases, however, the public use restriction on employing eminent domain looms ever larger. Thus, condemnation for "blight reduction," often a ruse for transferring title to a private developer, sweeps too broadly. If the "blighted" property constitutes an actual nuisance, it can be condemned under the police power, after all, without transferring title to another owner. A close cousin to the blight reduction rationale is the "economic development" rationale used in the infamous *Kelo* case and often used for the erection of privately owned sports stadiums; this rationale should never be allowed, whatever the claimed public benefit. Private economic development nearly always generates spillover benefits for the public, but that is no justification for using eminent domain. since private markets provide ample opportunities for obtaining the property needed for development the right way, by voluntary agreement. To avoid abuse and the potential for corruption, therefore, Congress needs to define "public use" rigorously, with reference to titles, use, and control.

"Just compensation." Finally, Congress should define "just compensation" with an eye to its function: it is a remedy for the wrong of taking someone's property. That the Constitution implicitly authorizes that wrong does not change the character of the act, of course. As discussed above, the rationale for this despotic power, even when properly used, is problematic. Given that, the least the public can do is make the victim of its use whole. That too will be a fact-dependent determination, but Congress should at least make it clear that for compensation to be "just" and hence to make the owner whole, he must receive more than the "market value" of his property, the normal standard today. After all, the simple fact that the owner does not have his property on the market indicates that its value to him is greater than the market price. Moreover, his compensation should reflect the fact that his loss arises not by mere accident, as with torts, but from a deliberate decision by the public to force him to give up his property.

In the case of regulatory takings, however, it should be noted that not every such taking will require compensation for an owner. Minimal losses, for example, may be difficult to prove and not worth the effort. Moreover, some regulatory restrictions may actually enhance the value of property—say, if an entire neighborhood is declared "historic." Finally, that portion of "just compensation" that concerns market value should reflect value before, and with no anticipation of, regulatory restrictions. Thus, in determining compensation, government should not benefit from reductions in value its regulations bring about. Given the modern penchant for regulation, that may not always be easy. But in general, given the nature of condemnation as a forced taking, any doubt should be resolved to the benefit of the owner forced to give up his property.

If Congress enacts general legislation that outlines the constitutional rights of property owners by following the common law in defining the terms of the Takings Clause, it will abolish, in effect, any real distinction between partial and full takings. Nevertheless, Congress should be explicit about what it is doing.

Treat Property Taken through Regulation the Same As Property Taken through Physical Seizure

The importance of enacting a unified and uniform takings law cannot be overstated. Today, we have one law for "full takings," "physical seizures," "condemnations"—call them what you will—and another for "partial takings," "regulatory seizures," or "condemnations of uses." Yet there is overlap, too. Thus, as noted above, the Court has said that if regulations take all uses, compensation is due—perhaps because eliminating all uses comes to the same thing, in effect, as a "physical seizure," whereas eliminating most but not all uses seems not to come to the same thing.

That appearance is deceptive, of course. In fact, the truth is much simpler—but only if we go about discovering it from first principles. If "property" signifies not only the underlying estate but all legitimate uses that by right can be made of it, then any government action that takes any one of those uses or rights is, by definition, a taking—requiring compensation for any financial losses the owner may suffer as a result. The issue is really no more complicated than that. There is no need to distinguish "full" and "partial" takings: *every* condemnation, whether full or partial, is a taking. Indeed, the use taken is taken "in full." Imagine that the property were converted to dollars—100 dollars, say. Would we say that if the government took all 100 dollars there was a taking, but if

it took only 50 of the 100 dollars there was not a taking? Of course not. Yet that is what we say under the Court's modern regulatory takings doctrine: as one justice put it, "takings law is full of these `all-or-nothing' situations."

That confusion must end. Through legislation specifying the rights of property owners, Congress needs to make it clear that compensation is required whenever government eliminates common law property rights and an owner suffers a financial loss as a result—whether the elimination results from regulation or from outright condemnation.

Provide a Single Forum in Which Property Owners May Seek Injunctive Relief and Just Compensation Promptly

The promise of the common law and the Constitution will be realized, however, only through procedures that enable aggrieved parties to press their complaints. Some of the greatest abuses today are taking place because owners are frustrated at every turn in their efforts to reach the merits of their claims. Accordingly, Congress should provide a single forum for owners to press their claims.

In its 1998 term, the Supreme Court decided a takings case that began 17 years earlier, in 1981, when owners applied to a local planning commission for permission to develop their land. After submitting numerous proposals over this period, each rejected, even though each satisfied the commission's previous recommendation, the owners finally sued, at which point they faced the hurdles the courts put before them. Most owners, of course, cannot afford to go through such a long and expensive process, at the end of which the odds are still against them. But that process confronts property owners across the nation today as they seek to enjoy and then to vindicate their rights. If it were speech or voting or any number of other rights, the path to vindication would be smooth by comparison. But property rights have been relegated to a kind of second-class status.

The first problem is the modern permitting regime. We would not stand for speech or religion or most other rights to be enjoyed only by permit. Yet that is what we do with property rights, which places enormous, often arbitrary, power in the hands of federal, state, and local "planners." Driven by political goals and considerations, planning commissions open the application forum not only to those whose *rights* might be at stake but to those with *interests* in the matter. Thus is the common law distinction between rights and interests blurred and eventually lost. Thus is the matter

transformed from one of protecting rights to one of deciding whose "interests" should prevail. Thus are property rights effectively politicized. And that is the end of the matter for most owners because that is as far as they can afford to take it.

When an owner does take it further, however, he finds the courts are often no more inclined to hear his complaint than was the planning commission. Federal courts routinely abstain from hearing federal claims brought against state and local governments, requiring owners to litigate their claims in state courts before they can even set foot in a federal court on their federal claims. Moreover, the Supreme Court has held that an owner's claim is not ripe for adjudication unless (1) he obtains a final, definitive agency decision regarding the application of the regulation in question, and (2) he exhausts all available state compensation remedies.

Needless to say, planners, disinclined to approve applications to begin with, treat those standards as invitations to stall until the "problem" goes away. Then, if an owner does spend years and extraordinary expense jumping through those hoops and he gets into federal court at last, he faces the *res judicata* restriction of the federal Full Faith and Credit Act: the court will say that the case has already been adjudicated by the state courts. Finally, if the claim is against the federal government, the owner faces the so-called Tucker Act Shuffle: he cannot get injunctive relief and compensation from the same court but must go to a district court for an injunction and to the Court of Federal Claims for compensation, each waiting upon the other to act.

The 105th and 106th Congresses tried to address those procedural hurdles through several measures, none of which passed both houses. Those or similar measures must be revived and enacted if the unconscionable way we treat owners—who are simply trying to vindicate their constitutional rights—is to be brought to an end. This is not an "intrusion" on state and local governments. Under the Fourteenth Amendment, properly understood and applied, those governments have no more right to violate the constitutional rights of citizens than the federal government has to intrude on the legitimate powers of state and local governments. Federalism is not a shield for local tyranny. It is a brake on tyranny, whatever its source.

Conclusion

The Founders would be appalled to see what we have done to property rights over the course of the 20th century. One would never know today that their status in the Bill of Rights was equal to that of any other right.

The time has come to restore respect for these most basic of rights, the foundation of all of our rights. Indeed, despotic governments have long understood that if you control property, you control the media, the churches, the political process itself. We are not, of course, at that point yet. But if regulations that provide the public with benefits continue to grow, unchecked by the need to compensate those who bear the costs, we will gradually slide to that point—and in the process we will pay an increasingly heavy price for the uncertainty and inefficiency we create. The most important price, however, will be to our system of law and justice. Owners are asking simply that their government obey the law—both the common law and the law of the Constitution. Reduced to its essence, they are saying simply this: stop stealing our property; if you must take it, do it the right way—pay for it. That hardly seems too much to ask.

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—Prepared by Roger Pilon

17. Overcriminalization

Policymakers should

- override the old maxim that "ignorance of the law is no excuse" (given the breadth of the criminal codes now on the books, that doctrine no longer makes sense);
- strengthen the rule of lenity for criminal cases by enacting a statute that explicitly provides for the strict construction of all criminal laws; and
- prohibit administrative agencies from creating new crimes.

Over the past 10 years, there has been much discussion in academic and policy circles concerning "mass incarceration" in the United States. Many have observed that there is something incongruous about America, the land of the free, finding itself with one of the highest incarceration rates in the world. The United States has about 2 million inmates and another 7 million persons under the "supervision" of the criminal justice system. Something is amiss, but the root of the problem is not sentencing policy; rather, it is the burgeoning criminal codes at the "front end" of the criminal system. Policymakers at all levels of government have criminalized so many activities that it should come as no surprise that our courthouses are clogged with cases and our prisons are overflowing with inmates. Politicians have recklessly sought short-term political advantage by taking "credit" for new laws while ignoring the long-term consequences of their policy decisions. It is no overstatement to say that the politics of criminalization threaten the very foundation of our free society.

The Legal Minefield

Every year American lawmakers add new crimes to the law books. Under the Constitution, crime fighting is supposed to be reserved to state

and local government. But over the past 40 years, Congress has federalized many of the crimes that have always been investigated by local police. Politicians have also found ways to recriminalize criminal conduct. "Hate crimes," for example, duplicate crimes such as murder and assault and add stiffer penalties when prosecutors can prove that bigotry was a motivating factor behind the violence.

The criminal law has also followed the rise of the regulatory state. In addition to the thousands of criminal laws, there are now tens of thousands of regulations that carry criminal penalties, including prison time. The web of rules has become so vast that it seems as if most Americans are now criminals whether they realize it or not.

The overcriminalization phenomenon extends beyond the realm of violence, fraud, vice, and commercial regulations. Consider these cases:

- A river guide saw a teenager in distress and so left his boat and swam to save her. He was charged with "obstructing government operations" for not waiting for the search and rescue team.
- Federal prosecutors indicted computer prodigy Aaron Swartz for improperly downloading articles from the digital library JSTOR. The Justice Department maintains that when a website owner's terms-of-service policy is violated, a crime is also committed—even though owners retain the right to change the terms at any time and without prior notice. Frightened by the prospect of bankruptcy, a long prison sentence, or both, Swartz took his own life.
- Retired race car driver Bobby Unser was prosecuted by federal authorities for driving his snowmobile on protected federal land. Unser and his friend got lost during a snowstorm and were desperately seeking shelter or assistance.
- Nevada rancher Dudley Hiibel was jailed for declining to give his name to a policeman.
- Members of a Christian outreach group were arrested and prosecuted for feeding the homeless in a Ft. Lauderdale park. Local rules restricted food sharing.

There was a telling moment before the Supreme Court in 2009 when a government lawyer was explaining the scope of the federal "honest services" law. The lawyer from the Department of Justice said that law criminalized any ethical lapse in the workplace. In response, Justice Stephen Breyer exclaimed, "There are 150 million workers in the United States. I think possibly 140 million of them flunk your test." The government lawyer did not deny Justice Breyer's observation. As unbelievable as it

may sound, the federal government considers more than a hundred million Americans to be criminals. And that is only under its interpretation of a single federal statute. As noted, there are thousands and thousands more. The overcriminalization phenomenon is thus quite real.

The Consequences of Overcriminalization

There are several reasons to be alarmed by the exponential growth of criminal rules and regulations. First and foremost, America has always prided itself on its freedom; but a society in which the criminal rules are so pervasive that no one is safe from arrest and prosecution cannot be described as free. The traditional common law crimes—murder, rape, theft, assault—do not restrict the freedom of the citizenry to live their own lives peaceably. However, as soon as the government goes beyond the basic crimes to prohibit other human activities, the adverse impact on liberty becomes evident. As the criminal law expands, there is a concomitant diminution of liberty.

Second, when criminal code violations become virtually unavoidable, the safeguards in the Bill of Rights become ineffectual. As the Harvard legal scholar Henry Hart observed, "What sense does it make to insist upon procedural safeguards in criminal prosecutions if anything whatever can be made a crime in the first place?" Hart's point was that if some rule can be shown to have been violated, a speedy trial cannot help the person facing a prison sentence. And an able defense attorney can only help his client by making a plea for leniency.

Third, law enforcement resources are limited. The police and courts are busy enough with violent crimes, theft, and extortion. Those cases will be neglected if the police are burdened with additional responsibilities. Andrew McCarthy, a former federal prosecutor, reminds us that there is no getting around the tradeoff: time and money "spent investigating conduct that is not inherently criminal are time and money lost to the thwarting of much more serious crime."

Fourth, policymakers should always pause to remember that every rule brings about the possibility that the police will have to employ violence to enforce that rule. Eric Garner was killed by New York City police as they were trying to enforce a rule against selling individual cigarettes ("loosies") on the street. Yale Law School professor Stephen Carter has noted that if policymakers want to seriously reduce the opportunities for dangerous interactions between police and civilians, they should stop talking about "better police training" and scale back the criminal codes.

Fifth, another inevitable consequence of overcriminalization has been more governmental errors. Innocent people are sometimes arrested, prosecuted, and imprisoned. Wrongful convictions are not only unjust to the prisoner, but to his or her family—children, spouse, parents, and siblings. One effective way to limit those miscarriages of justice is to keep the criminal system as small as possible. If America has two million people imprisoned and the government has done its job properly in 95 percent of the cases, that means 100,000 people are unjustly imprisoned. By scaling back the criminal codes, so that the total number of people prosecuted and imprisoned is reduced, policymakers could also reduce the number of innocent persons mistakenly imprisoned.

Reform Measures

Of course, overcriminalization can be addressed in many ways. The following are three possible routes to correcting the system.

Override the Old Maxim That "Ignorance of the Law Is No Excuse"

It is absurd and unjust for the government to impose a legal duty on every citizen to "know" all of the mind-boggling rules and regulations that have been promulgated over the years. The old maxim that "ignorance of the law is no excuse" only makes sense when the criminal law covers conduct that is plainly and inherently wrongful, such as murder and theft.

To illustrate the rank injustice that can occur, take the case of Carlton Wilson, who was prosecuted because he possessed a firearm. Wilson's purchase of the firearm was perfectly legal. Years later, a judge issued a restraining order against Wilson during his divorce proceedings. He didn't know that meant he had to give up the firearm. When Wilson protested that the judge never informed him of that obligation and that the restraining order itself said nothing about firearms, prosecutors shrugged, "ignorance of the law is no excuse." Although the courts upheld Wilson's conviction, Judge Richard Posner filed a dissent: "We want people to familiarize themselves with the laws bearing on their activities. But a reasonable opportunity doesn't mean being able to go to the local law library and read Title 18. It would be preposterous to suppose that someone from Wilson's milieu is able to take advantage of such an opportunity." Judge Posner noted that Wilson would serve more than three years in a federal penitentiary for an omission that he "could not have suspected was a crime or even a civil wrong."

Policymakers should override the "ignorance-is-no-excuse" maxim by enacting a law that requires prosecutors to prove that regulatory violations are "willful" or, in the alternative, that permits defendants to plead a good-faith belief in the legality of one's conduct. The former rule is already in place for our complicated tax laws. It should also shield unwary Americans from all laws and regulations as well.

Strengthen the Rule of Lenity

Even if there were only a few crimes on the books, the terms of our criminal laws ought to be drafted with precision. After all, there is little difference between a secret law and a published regulation that cannot be understood. The American Revolutionaries believed in the Latin maxim *nullum crimen sine lege*, which means there can be no crime without a law. In other words, people can be punished only for conduct previously prohibited by law. That principle is clearly enunciated in the ex post facto clause of the Constitution (Article I, Section 9). But the purpose of that clause can be subverted if the legislature can enact a criminal law with vague terms that can be interpreted broadly by prosecutors or judges. Such a law would not give citizens fair warning of the prohibited conduct.

One way to address the problem of vague laws that were previously enacted would be for legislators to direct the courts to follow the "rule of lenity." That doctrine resolves legal uncertainties in favor of the accused, not the government. Unfortunately, the courts have not invoked that doctrine consistently.

Prohibit Administrative Agencies from Creating New Crimes

Beyond the thousands of criminal statutes enacted by legislatures, there are also thousands of regulations that carry criminal penalties. It is the responsibility of elected officials to carefully consider what infractions can result in a criminal conviction and prison time.

The case law that has thus far allowed the delegation of lawmaking has drawn criticism. U.S. district judge Roger Vinson, for example, has observed:

> A jurisprudence which allows Congress to impliedly delegate its criminal lawmaking authority to a regulatory agency such as the Army Corps—so long as Congress provides an "intelligible principle" to guide that agency—is enough to make any judge pause and question what has happened. Deferent and minimal judicial review of Congress' transfer of its criminal lawmaking function to other bodies, in other branches, calls into question

> the vitality of the tripartite system established by our Constitution. It also calls into question the nexus that must exist between the law so applied and simple logic and common sense.

Making conduct criminal is a serious matter. It is a decision that ought to be made by the people's elected representatives, whether in Congress, the state legislatures, or city councils.

Conclusion

Political observers have noted that criminal justice reform is one of the few policy areas that is now finding support from across the political spectrum. On the left, law professor Michelle Alexander, author of *The New Jim Crow: Mass Incarceration in the Age of Colorblindness*, tells her students that even though she has earned fancy degrees, she is a criminal. She challenges others to come clean as well. After all, just because a person has not been caught does not mean she is not a criminal in the eyes of the law. Alexander believes reform will happen when more people come to terms with their own "criminality." On the right, U.S. circuit judge Alex Kozinski makes a similar point in his article, "You're (Probably) a Federal Criminal." Most Americans are criminals, but don't know it, he writes.

There are some indications that the policy climate is becoming more receptive to fundamental reform. A recent cover story in *Harper's* was titled, "Legalize It All: How to Win the War on Drugs." A few weeks later, a cover story in *The New York Times Magazine* posed the question, "Should Prostitution Be a Crime?" While these questions are still being debated, it seems clear that more and more people are coming to recognize that vices are not crimes that warrant the intervention of police powers. Over the past few years, policymakers in Vermont, Maine, Colorado, and New Hampshire have voted to repeal criminal laws regarding adultery. These developments are welcome, but policymakers should move more aggressively toward criminal code reform and prune the law books of unnecessary and unjust criminal provisions. An expansive criminal code is inimical to a free society.

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—Prepared by Timothy Lynch

18. White-Collar Prosecution

Congress and state lawmakers (and where appropriate, the president and executive branch law enforcement officials) should

- review existing law with an eye toward rolling back over-criminalization and replacing criminal penalties with civil sanctions where feasible;
- enact reforms such as the model Criminal Intent Protection Act to bolster recognition of *mens rea* (punishment should ordinarily require a guilty state of mind, not inadvertent noncompliance) as well as the related *mistake of law defense* in criminal law;
- codify the common law rule of lenity (ambiguity in law should be resolved against finding guilt), as Texas joined other states in doing in 2015;
- devise safe harbor provisions that enable economic actors to avoid criminal liability by behaving reasonably and in intended compliance with the law;
- limit agency discretion to create new crimes without an act of the legislature;
- enact guidelines to strengthen judicial oversight of deferred prosecution agreements and nonprosecution agreements (explicit court approval, not the unilateral say-so of government prosecutors, should be required for appointment of corporate monitors or the extension of time under supervision);
- enact asset forfeiture reforms such as Rep. Jim Sensenbrenner's (R-WI) Due Process Act, including requiring that conviction be a prerequisite for forfeiture;

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- review and, where appropriate, reduce or coordinate per-offense fines and sanctions to avoid levying penalties disproportionate to the gravity of misconduct;
- prohibit, as a proposed New Mexico law would do, the allocation of settlement moneys (cy pres) to charities, nonprofits, or advocacy groups not themselves injured;
- assign penalties, forfeitures, and settlement proceeds to the public treasury or, where appropriate in certain cases, to private parties who can show specific individual injury from the offense (penalties should not fund particular government agencies in ways that incentivize zealous enforcement or insulate the agencies from appropriations oversight);
- prohibit the payment of public lawyers and forensics experts on contingency, that is, in ways dependent on case outcome or the magnitude of penalties (this principle should apply alike to career prosecutors, other staff public lawyers, experts, and outside law firms); existing contingency arrangements should be terminated;) and
- impose transparent principles of selection and payment on outside contracting for legal services.

Prosecution: A Climate of Abuse

"The increasing criminalization of corporate behavior in America," noted *The Economist* in 2014, "is bad for the rule of law and for capitalism." In fact, the British weekly noted, prosecution as a means of regulating business in the United States has become "an extortion racket. . . . The formula is simple: find a large company that may (or may not) have done something wrong; threaten its managers with commercial ruin, preferably with criminal charges; force them to use their shareholders' money to pay an enormous fine to drop the charges in a secret settlement (so nobody can check the details). Then repeat with another large company. . . .

"Perhaps the most destructive part of it all is the secrecy and opacity. The public never finds out the full facts of the case, nor discovers which specific people—with souls and bodies—were to blame. Since the cases never go to court, precedent is not established, so it is unclear what exactly is illegal. That enables future shakedowns, but hurts the rule of law and imposes enormous costs."

Many abuses arise from prosecutors' search for publicity and glory. These include splashy raids on offices and "perp walks" for executives, in situations where a simple request to cooperate would have sufficed, and manipulation of the media through leaks and prejudicial publicity.

The most natural way to address prosecutorial abuse might seem to be disciplinary sanctions based on traditional standards of legal ethics and applied by judges or bar panels. The trouble with relying on that solution is that few prosecutions of large businesses eventuate in trial before a judge. When a business does put up a fight, it sometimes wins big. In 2016, after the Department of Justice (DoJ) indicted the FedEx Corporation on charges that it had knowingly done business with illegal pharmacies, FedEx refused to settle; once before a judge, DoJ's case collapsed in spectacular fashion and it dropped the charges midtrial. Much more often, however, businesses faced with a doubtful or overreaching prosecution take their lawyers' advice and fold their hands and try to get the best possible settlement. For businesses based on trust or regulatory permission, the costs and risks of defying federal law enforcement—legal, reputational, and otherwise—are just too high. The government has the upper hand. That is one reason lawmakers need to step in.

Overcriminalization and the Need for Clear and Compliable Law

There are now more than 4,000 federal criminal offenses, up from approximately 165 in 1900, 2,000 in 1970, and 3,000 in 1982, along with hundreds of thousands of regulations backed up by criminal sanction.

Under the rule of law, citizens should be able to arrange their actions so as to avoid the commission of crimes. Yet the proliferation of highly technical laws, many going beyond the prohibition of intrinsically wrongful acts, makes it more likely that even a careful business with thousands of employees will commit some violations—especially if criminal infraction of regulations can be assessed without reference to *mens rea* (i.e., guilty intent).

As Sen. Ted Cruz (R-TX) has written, "Congress should enact legislation that requires the government to prove the defendant knowingly violated the law—or that, at least, allows a `mistake of law' defense—for certain classes of crimes that have no analog in the common law or that no reasonable person would understand to be inherently wrong. Where the government has criminalized non-blameworthy conduct for regulatory purposes, ignorance of the law should be a valid defense to criminal liability."

Four Outrageous Business Prosecutions

- "When I got there, there were people in SWAT attire that evacuated our entire factory." Thirty federal agents raided the headquarters of Nashville's legendary Gibson Guitar, carting away a fortune in wood and instruments and interrogating staff without benefit of a lawyer. The charge was that the company had used small quantities of imported wood without doing enough to ascertain suppliers' compliance with a federal law called the Lacey Act. Gibson's chief executive officer—who "had not received so much as a postcard telling the company it might be doing something wrong"—got a letter the next day warning him that if he so much as touched any guitar left in the plant he could be charged with a separate federal offense, with possible jail time, for each "violation." After much press coverage sympathetic to the company, the feds settled for a relatively low $300,000, a sum far below what Gibson would have been likely to pay in legal defense, and returned the seized instruments.
- The federal government extracted more than a billion dollars from Toyota in a settlement, even though its own engineers at the National Highway Traffic Safety Administration cleared the Japanese automaker of charges that its cars were subject to runaway acceleration. The penalties were mostly premised on minor regulatory infractions unrelated to any injuries or accidents. The Department of Justice's press announcement employed language suggesting that the problem of mechanical acceleration had been real, though Washington had good reason to know better.
- The federal government and various states, notably New York, launched enforcement actions against major banks whose actions, it was alleged, had helped propel the mortgage bubble and crash of 2008. No one really knew, and no court ever decided, whether the charges were true or what a suitable penalty level might be. When the dust settled, major banks had agreed to pay record settlements, some going to investors and consumers, but with hundreds of

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millions also going to nonprofit organizations that the various law enforcement officials saw as worthy causes—which, in the case of the Obama administration and the attorney general of New York, happened also to be close political allies.

- Several small family-owned retailers, including a Maryland dairy farm, a Detroit-area grocery, and a North Carolina convenience store, violated the little-known federal "structuring" law, which prohibits depositing money into banks in sums under $10,000 so as not to trigger a paperwork filing to the government, even when no tax or other laws are being evaded in the process. Federal agents seized the families' bank accounts. With volunteer legal help, and amid public outcry, all three businesses managed to get their money back. But many other small businesses swept up by the same law, sometimes unable to pay lawyers because of the freeze on their assets, had by that time capitulated to large forfeitures.

The situation is even worse when laws are so vague that even reading them does not give fair notice of what they prohibit. Courts are inconsistent about applying the "rule of lenity" (ambiguities should be resolved against finding guilt) and the "void for vagueness doctrine" (laws can fail constitutional muster if they leave too much doubt about what they prohibit). As a result, certain areas—including federal mail and wire fraud, "honest services" fraud, antitrust law, and securities law—have proved particularly resistant to clarification.

In recent years, the U.S. Department of Justice has also sought to expand something called the "responsible corporate officer doctrine." That doctrine allows the government to hold executives criminally liable for the sins of the corporation generally, even when those executives have not been shown to personally hold a guilty state of mind. Although the doctrine somehow passed muster at the U.S. Supreme Court in the cases of *United States v. Dotterweich* (1943) and *United States v. Park* (1975), it is ripe with potential for injustice.

Settlements and Slush Funds

Deferred prosecution agreements (DPAs) and their close relatives, nonprosecution agreements (NPAs), have become a major tool of white-collar

prosecution in recent years. Typically, in exchange for avoiding trial, a business defendant agrees to some combination of cash payment, agreement to change behavior, and submission to future oversight by DoJ. Often, DoJ assigns "monitors" with broad, vaguely defined powers to oversee the affairs of defendant companies and report back to Washington on an ongoing basis.

NPAs at the federal level date back only to 1992. But they have multiplied rapidly, from 1 or 2 a year in the nineties to more than 30 a year during the Obama administration. Since 2010, 16 of the largest U.S. businesses have come under Department of Justice supervision, with tens of billions of dollars extracted in settlements.

Notably, in these agreements, a business defendant may pledge to alter its future course of action in ways that a court would never have ordered had the case gone to trial but that the government is interested in extracting as concessions. These deals may have the effect, or even the aim, of helping or hurting third parties who have the ear of the government, such as customers or competitors of the targeted defendant.

"Without any adjudication to establish wrongdoing and without any judicial oversight, businesses have agreed through these settlements to remove or replace key officers and directors; to change sales, marketing, or compensation plans; and to appoint new officers or independent `monitors' reporting to prosecutors but paid by the companies," write James Copland and Isaac Gorodetski. The two argue that this process adds up to a "shadow regulatory state" lacking many of the administrative law protections of the visible regulatory state. Appointed monitors, in particular, can wield ill-defined but wide-ranging power with little accountability if it is put to heavy-handed use.

What to do? The United Kingdom took an early lead with its 2013 Crime and Courts Act, which, among other provisions, directs judges to determine that the provisions of DPA equivalents are "fair, reasonable, and proportionate." In the U.S. Congress, a proposal called the Accountability in Deferred Prosecution Act of 2014 attempted to pursue similar principles. Much more is needed if U.S. law is to catch up with the institutional reality of a Department of Justice that has become the nation's most powerful business regulator without anyone's having designed it that way.

At base, the case for civil liberties in the business world is much the same as the case for civil liberties generally. Businesses deserve impartial prosecution in the interests of justice, not merely scoring wins for the

government; speedy trial and clear exposition of charges; determination of guilt on an individualized, not group, basis; no excessive punishment; protections against baseless search and seizure; and, in general, the full range of due process protections. The marketplace, like the rest of American society, deserves the full protections of the U.S. Constitution.

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—Prepared by Walter Olson

19. Technology and Law Enforcement

Congress should

- ensure that all federal law enforcement grants are conditioned on policies that protect privacy and promote transparency and accountability;
- impose a probable cause requirement on the collection of metadata through cell phone tracking devices used by federal law enforcement agencies, including joint federal/state task forces; and
- direct the FBI and the FCC to rescind the nondisclosure agreements and secrecy policies that federal agencies negotiate with state and local law enforcement partners regarding cell phone tracking devices, or stingrays.

Since the beginning of modern policing in 1829, law enforcement agencies have taken advantage of new technologies. As automobiles, cameras, Tasers, radios, airplanes, and eavesdropping devices arrived, police were quick to put the new technology into the field. However, recent developments in surveillance technology, combined with a lagging Fourth Amendment jurisprudence, have jeopardized the constitutional rights of millions of American citizens without adequate legislative oversight. Modern technology gives police access to tools such as body cameras, drones, and cell phone tracking devices that could, without appropriate regulations in place, allow for the warrantless and persistent surveillance of entire American cities.

Law enforcement agencies have a legitimate interest in the use of body cameras, drones, and cellular phone trackers, but that interest must be weighed against the privacy interests and constitutional rights of American citizens. Our system of checks and balances obligates legislators and judges

to ensure that law enforcement practices respect the rights of the American people.

While law enforcement is traditionally a state and local function in our federal system, over the last few decades the federal government has increasingly injected itself into local law enforcement through the proliferation of grant awards and equipment transfer programs. Ostensibly meant to help fight the drug war and the War on Terror, these federal interventions in local law enforcement serve to distort law enforcement priorities while granting the federal government a massive role in shaping law enforcement policy at the state and local level.

Congress should consider the policies outlined below, which would allow law enforcement agencies to take advantage of new technology while also increasing law enforcement accountability and transparency and guarding against persistent and indiscriminate surveillance.

Cell Phone Tracking

Cell phone trackers are colloquially referred to by the Harris Corporation trade name "StingRay" or the technical term "IMSI-catchers" (i.e., the International Mobile Subscriber Identity of nearby mobile phones). These devices operate by emitting radio signals and are regulated under the authority of the Federal Communications Commission (FCC). The FCC, in turn, requires state and local law enforcement agencies to coordinate their acquisition of stingrays with the Federal Bureau of Investigation (FBI). Pursuant to that requirement, the FBI has proffered a nondisclosure agreement to state and local agencies applying to use stingrays. Among other things, the nondisclosure agreement forbids the law enforcement agencies from disclosing any information about the use or capabilities of the technology to the public, courts, or defendants. The agreement even gives the FBI the authority to compel local prosecutors to withhold evidence or even drop entire prosecutions rather than disclose stingray evidence.

For example, a judge in New York State ordered the Erie County sheriff's office to disclose the terms of its nondisclosure agreement with the FBI. The agreement included the following provision:

> In addition, the Erie County Sheriff's Office will, at the request of the FBI, seek dismissal of the case in lieu of using or providing, or allowing others to use or provide, any information concerning the Harris Corporation wireless collection equipment/technology, its associated software, operating manuals, and any related documentation (beyond the evidentiary results obtained through the use of the equipment/technology), if using or provid-

ing such information would potentially or actually compromise the equipment/technology.

The federal government's demand for such extensive secrecy threatens privacy rights and undermines important federalism and separation of powers principles. Congress should direct the FBI and FCC to abolish such requirements for state and local stingray use.

The level of secrecy surrounding stingrays has made it difficult for courts to oversee the operation of the devices. With prosecutors, at the behest of the FBI, dropping cases rather than acknowledging stingray use, the jurisprudence is relatively sparse—despite the thousands of stingray deployments around the country. In the last year, however, the use of stingrays has garnered more attention from defense attorneys, courts, and legislators.

A Maryland state appeals court recently found that a warrantless use of stingray equipment to track down an attempted murder suspect was a violation of the Fourth Amendment. The court concluded that the suspect had a reasonable expectation of privacy in the location of his cell phone within an apartment. The federal Second Circuit Court of Appeals recently reached the same conclusion about another warrantless stingray search of an apartment.

Rather than wait for the courts, several state legislatures have taken steps to prevent stingray abuses by state and local law enforcement. Illinois, for instance, recently passed the Citizen Privacy Protection Act, which requires a showing of probable cause before a court will authorize the deployment of a stingray device. Congress should do the same and impose a warrant requirement on the collection of telephony metadata or digital content by stingray technology.

Body Cameras

The body camera, another tool that raises federalist concerns, has become an increasingly prominent hallmark of criminal justice reform debates. Overwhelmingly popular among the public and used by an increasing number of police departments, body cameras can help improve evidence gathering as well as accountability and transparency in law enforcement. In December 2014, a month after it was announced that Ferguson, Missouri, police officer Darren Wilson would not face charges over the killing of Michael Brown, the Obama administration proposed 50 percent matching funds for the purchase of 50,000 police body cameras.

In 2015, the Department of Justice announced that more than $23.2 million worth of body camera funds would be awarded to police departments in 32 states. Body camera funds worth more than $20 million were also awarded to 106 law enforcement agencies in 32 states and Puerto Rico in 2016. It's not surprising that the federal government has awarded body camera funds. In the wake of Brown's killing, there were renewed discussions about police use-of-force and police interactions with the communities they serve. The deaths of Alton Sterling, Samuel DuBose, Walter Scott, five Dallas police officers, and many others have maintained the urgency of these discussions. But while body cameras are popular, it's important to note that they can be expensive; federal grants will appeal to departments that otherwise would struggle with the fiscal impact of a body camera program.

Drones

Unmanned aerial vehicles (UAVs), commonly called "drones," vary considerably in size and capability and are used to collect video data. Unlike body camera programs, which do not require federal permission to use, drones are already regulated by the federal government. Police departments and other public entities can fly drones after either receiving a Certificate of Waiver or Authorization from the Federal Aviation Administration (FAA), or by operating drones under "Part 107" rules, which require (among other things) that the drone be in the line of sight of the pilot and not be flown over people, although police departments can request that those requirements be waived.

Still, under certificates and "Part 107" rules, police departments are not required to adhere to the types of privacy and transparency policies necessary to protect the rights of Americans from excessive government intrusion. Indeed, as the head of the FAA's Unmanned Aircraft Systems Integration Office said in 2013, "The FAA has no authority to make rules or enforce any rules relative to privacy." Congress, however, *can* condition law enforcement grants on the acceptance of policies that protect important constitutional values.

Transparency, Accountability, and Privacy

Stingrays, body cameras, and drones can play a role in improving law enforcement by making it easier for police to search for suspects and missing persons and gather evidence. Body cameras in particular can be

valuable in promoting increased accountability and transparency in law enforcement. However, these benefits come with significant privacy concerns that Congress should address.

Each of these tools is capable of collecting a vast amount of sensitive data. Subjects of body cameras include not only the victims of crimes, but children, informants, and those involved in accidents. In addition, police body cameras can film inside homes.

As for UAVs, in the course of collecting video data, drones can gather information about backyards and other private property observable from the air. Thanks to Supreme Court rulings from the 1980s, warrantless naked-eye aerial surveillance of backyards is *not* proscribed. Thus, in the absence of restrictive regulations, Americans may have to adapt to a heightened level of surveillance: the explosion in the number of drones means that police will be able to snoop on people hosting barbecues, sunbathing, gardening, or playing with their children in backyards without having to secure a warrant first. That would be disturbing enough if drones were outfitted only with cameras, but they can also be used as platforms for a host of other surveillance tools such as license plate readers and thermal imagers.

Stingrays, which can be helpful in locating suspects and kidnapping victims, nonetheless present an array of privacy and constitutional issues. While the full capabilities of the devices remain shrouded in secrecy, the ability to intercept content from the cell phones of everyone in a given geographic area without a warrant or even notification to the user is troubling. Telephony metadata such as call times, durations, and incoming and outgoing numbers allows the government to piece together the intimate, private details of an individual's life. While the government insists that its stingray devices "are not configured" to intercept the actual content of calls, the capability exists. Without proper oversight that capability will remain an even greater threat to privacy than the bulk collection of metadata and warrantless location tracking.

In addition to privacy concerns associated with modern policing, there are also worries about transparency. Despite widespread international coverage of American police killings, the standard of nationwide data on fatal police encounters is poor. Journalism outlets, not government bodies, provide the most comprehensive databases.

New technologies do help police gather evidence; but under the right guidelines, those technologies can also play a role in informing the public about law enforcement activities. As more and more police departments

seek out new technologies, Congress should ensure that the federal government only funds or lends drones, body cameras, and stingrays for law enforcement agencies that demonstrate a commitment to transparency, accountability, and privacy.

Conditions for Use of Equipment

At a minimum, any of America's roughly 18,000 law enforcement agencies applying for federal grants related to body cameras, drones, or stingrays or seeking to borrow such equipment from federal agencies should outline policies that protect privacy and are consistent with increased accountability and transparency in law enforcement. Unfortunately, federal law enforcement grants have too often been awarded to police departments with poor policies. To promote increased law enforcement transparency and accountability while protecting privacy, Congress should make federal law enforcement grants conditional on agencies' adherence to the following requirements:

Transparency

- Regularly publish the number of drones, body cameras, and IMSI-catchers the agency has, how often these tools are used, and how much data they collect.
- Make the agency's drone, body camera, and IMSI-catcher policies available online.
- Collect and regularly release data related to use-of-force incidents, including those unrelated to the use of body cameras, drones, and IMSI-catchers.
- Publish specifications allowing courts, defense attorneys, and the public at large to understand the full capabilities of the surveillance devices in use.

Accountability

- Make available footage of incidents of public interest.
- Prohibit officers from viewing UAV or body camera footage before making statements related to a use-of-force incident.
- Establish guidelines that clearly state when body cameras should be on: during traffic stops, searches, arrests, detentions, use-of-force incidents, and all 911 responses.
- Ban drones from being outfitted with lethal as well as nonlethal weapons.

Privacy

- Require law enforcement agencies to secure a warrant before using an IMSI-catcher or UAV, except in exigent circumstances.
- Ban the release of UAV and body camera footage showing the interior of private residential property.
- Ban the collecting and/or reading of text message and phone call content collected by IMSI-catchers without a warrant.
- Ban the use of biometric software on body camera and UAV data.

Finally, Congress should take steps to apply these policies to federal law enforcement agencies. Those agencies are not only some of the country's largest law enforcement agencies, but also some of the best funded.

Since the advent of the drug war and the War on Terror, the federal government has become a powerful and pervasive influence on state and local law enforcement policies. As long as the federal government maintains that role, Congress should endeavor to protect Americans' most cherished constitutional rights and prevent abuse. Congress should require appropriate transparency, accountability, and privacy-respecting policies before flooding state and local law enforcement agencies with grant money and cutting-edge surveillance technology.

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—Prepared by Adam Bates and Matthew Feeney

20. Stopping Police Militarization

Congress should

- amend 10 U.S.C. § 2576a to stop transfers to local law enforcement agencies of any military equipment listed on either the Department of State Munitions Control List or the Department of Commerce Control List—so-called "controlled property"—and repossess all currently distributed controlled property;
- failing that, ensure that any currently and subsequently distributed controlled property is subject to extensive reporting requirements and randomized audits;
- mandate that the use of controlled property against misdemeanors or "Part II index crimes" (as described in the Uniform Crime Reports)—that is, nonviolent, less-serious crimes, including drug use, possession, and cultivation—requires a secondary report listing the articulable reasons for believing the specific situation posed a particular threat; and
- require law enforcement agencies with a track record of using extreme force against Part II index crimes, including and especially drug possession and use, to be subject to further investigation, discipline, and controlled property repossession.

The "1033" program was created as part of the National Defense Authorization Act (NDAA) for fiscal year 1997. In 1990, the first incarnation, then known as "1208," allowed the Department of Defense to transfer to local law enforcement agencies (LEAs) property that was "excess to the needs of the Department," including armored vehicles and small arms, to be used by LEAs in counter-drug activities. The 1997 NDAA changed

the designation to "1033" and expanded the permitted uses to broadly include "law enforcement activities." In 1990, the department transferred $1 million worth of gear; in 2013, it was $450 million.

The bulk of the gear is not dangerous—including office furniture, computers, and personal protective equipment. But the program also transfers high-powered military gear—so-called "controlled property"—that has few justified uses in domestic law enforcement. Congress should end the profligate transfer of such excessive military gear. However, if controlled property is to be transferred, Congress should ensure that LEAs use it rarely and responsibly.

Controlled property includes such things as armored vehicles and troop carriers, high-caliber firearms, and grenade launchers. Although such items can improve officer safety—officers who approach a crime scene in an armored carrier are marginally safer than those using other modes of transportation—it is now clear that the costs outweigh the benefits. During a period of significant decline in violent crime, the number of violent Special Weapons and Tactics (SWAT) raids has skyrocketed.

In 1980, when the violent crime rate was approximately 63 percent higher than it is now, there were on average three SWAT raids per day nationwide; now there are about 120. Shockingly, the vast majority of those SWAT raids are undertaken merely to execute search warrants, 60 percent of the time for drugs. According to the American Civil Liberties Union, only 7 percent of SWAT deployments were for hostage situations or barricaded shooters, the original purpose for creating SWAT teams. In short, each day, local police are violently raiding homes approximately 120 times, mostly for nonviolent offenses. In the process, they destroy property, often kill pets, sometimes injure or kill innocent people, and generally create an unhealthy atmosphere of fear and distrust.

These raids occur because federal transfers have given LEAs the necessary equipment and because there is little to no accountability for misusing that equipment. Ending police abuse of controlled property will require seemingly drastic steps to ensure that LEAs do not persist in believing that "if we have it, we might as well use it." A federal fix to this problem must focus on both stopping the transfer of controlled property and repossessing the property already distributed.

There are currently over 600 Mine-Resistant Ambush Protected vehicles in the hands of LEAs, as well as hundreds of grenade launchers and tens of thousands of high-powered assault rifles. Overall, there are approximately 460,000 pieces of controlled property in the hands of local law enforce-

ment. No serious attempt at reforming police militarization can commence until that gear is removed from their possession and its distribution is reassessed. Watertown, Connecticut (population 22,514), does not need a Mine-Resistant Ambush Protected vehicle, nor does Bloomington, Georgia (population 2,713), need four grenade launchers.

If Congress decides to continue distributing controlled property and to leave distributed property in the possession of LEAs, however, Congress must ensure that it is used responsibly and justifiably. After all, a rarely used armored troop carrier gathering dust in a police department parking lot should be seen as a good thing—it speaks to a safe and well-policed community. Rather than "if we have it, we might as well use it," LEAs should be encouraged to adopt a "we have it and hope we never use it" philosophy.

By requiring extensive reporting on the use of distributed controlled property, Congress can help ensure that SWAT teams are used rarely and only in exceptional circumstances. Reporting requirements should include when the equipment was used, which suspected crimes or crowd-control situations it was used against, whether shots were fired, whether suspects allegedly brandished a weapon, whether any person or animal was killed or injured in the process, whether forced entry was used, whether a warrant was served under either no-knock or knock-and-announce circumstances, whether any children or elderly individuals were on the premises, whether the possible presence of children or the elderly was investigated, and a copy of the warrant (if used) explaining the probable cause for the action. Moreover, audits of LEA compliance should be periodically and randomly carried out. Consistently noncompliant LEAs should be immediately stripped of their property.

Finally, using SWAT teams to address nonviolent crimes, such as drug use, possession, and distribution, should be strongly discouraged. Nonviolent crimes—generally described as "Part II index crimes" in the Federal Bureau of Investigation's Uniform Crime Reports—almost never deserve a violent response. Exceptional circumstances, such as a suspected drug producer with an arsenal and a history of violent crime, might justify a militarized response; but such a justification should never be presumed. LEAs should be required to report specific and particularized facts that require the use of controlled property to address a nonviolent crime. Consistent violation of these requirements should result in investigation, discipline, and property repossession.

The Obama administration recently took a special interest in the problem of police militarization. In May 2015, the president's Law Enforcement

Equipment Working Group issued recommendations that later became policy. Many of those new policies are similar to those in this chapter: establishing a list of prohibited property that cannot be acquired by LEAs (e.g., tracked armored vehicles, bayonets, grenade launchers, and large caliber weapons and ammunition); establishing a list of controlled property that LEAs can acquire if they provide additional information, certifications, and assurances (e.g., wheeled armored or tactical vehicles, specialized firearms and ammunition, explosives and pyrotechnics, and riot equipment); and increased federal oversight and compliance.

The administration's policy changes were laudable, but they are also less permanent than a statute passed by Congress. Moreover, the administration did not go far enough to ensure that dangerous military equipment isn't used against nonviolent crime, particularly drug crimes. Working groups and oversight committees are a step in the right direction, but they are no substitute for significant statutory changes. America's police forces have become too militarized, and it will take strong and unapologetic action from Congress to fully fix the problem.

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—Prepared by Trevor Burrus

21. National ID Systems

Policymakers should

- resist identification requirements and data collection, especially biometric data;
- decline to implement the REAL ID Act, defund it, and repeal it;
- abandon the E-Verify background check system; and
- encourage the development and acceptance of private identification systems.

A national identification (ID) card has long been regarded as contrary to the American character, and leading American political figures have opposed it whenever it has been proposed. But the creation of a national ID is becoming more likely with advances in identification technology and the adoption of policies that weave together the constituents of a national ID system or that implement a national ID directly. Avoiding a U.S. national ID requires diligent attention to the privacy costs of identification and tracking policies at all levels of government.

Leading Figures Have Long Opposed a National ID

American politicians across the spectrum have opposed having a national ID, even in the face of promises that such a system would help control illegal immigration. When President Ronald Reagan's attorney general, William French Smith, advocated in a cabinet meeting for support of a national ID card for illegal immigration control, the president reportedly scoffed, "Maybe we should just brand all the babies."

In the same context, Democratic presidential candidate Walter Mondale said, "We've never had citizenship tests in our country before. And I don't think we should have a citizenship card today." Speaker of the House Thomas P. "Tip" O'Neill Jr. (D-MA) said in a 1987 debate over immigra-

tion reform, "Hitler did this to the Jews, you know. He made them wear a dog tag."

A decade before that, conservative eminence Sen. Barry Goldwater (R-AZ) recognized and objected to the surveillance consequences and power shifts caused by national ID systems. In a debate on the Privacy Act of 1974, he said:

> Once the social security number is set as a universal identifier, each person would leave a trail of personal data behind him for all his life which could be immediately reassembled to confront him. Once we can be identified to the administration in government or in business by an exclusive number, we can be pinpointed wherever we are, we can be more easily manipulated, we can be more easily conditioned, and we can be more easily coerced.

A national identity system works against the interests of free people and a free society in several ways. One is by undercutting individuals' privacy. A widely used identification system makes the collection of identity information easier and more economical. Under a national ID, governmental and corporate bodies would collect more records of people's actions and movements. Whether directly or by inference, that would needlessly expose people's relationships, business activities, political leanings, social life, sexuality, and more.

This is not just a question of feelings about privacy or exposure. National ID systems shift power from individuals to institutions. They do provide genuine benefits, but extensive databases of personal information also render people more susceptible to the influence or control of data holders.

A national ID system would also place extraordinary power with the issuer of cards or the controller of the system. If showing ID is a gating function for access to goods, services, and infrastructure, then denying someone an ID allows the issuer to control access to those things. In a national ID system, the ID issuer can condition ID—and thus access to society—on obeying its commands.

Weaving Together a National ID

One might be inclined to think that U.S. state programs cannot create a national ID system. They can. It is national uniformity in data elements, not a national program, that constitutes a national ID system, with all its concerning effects. That is the first element of a national ID: use at a national scale.

The second hallmark of a national ID is that its possession or use is either practically or legally required. An identity card that everyone must carry is obviously a national ID card. A card or system that is one of many options for proving identity or other information is not a national ID; people can decline to use it and still easily access goods, services, or infrastructure. If law or regulation makes it very difficult to avoid carrying a card or using the system, then that puts the card or system into the national ID category. A system that automatically recognizes people presenting themselves in public, such as through facial recognition, is impossible to avoid and is thus practically required.

The final element of a national ID is that it is used for identification. This notion is fairly simple, but there are some subtleties. Identification occurs when a card or system shows that a physical person identified previously is the one appearing on later occasions. A national identifier like the Social Security number is not a full-fledged identification system. The Social Security number correlates names and numbers without making a biometric tie between the number and a physical person.

A variety of state programs threatens to produce a national ID, including facial recognition systems, license plate readers, and state participation in the federal government's Next Generation Identification (NGI) program. State mandates to use "E-Verify" and the "RIDE" (Records and Information from Department of Motor Vehicles for E-Verify) information-sharing program also advance the cause of national identification.

Facial recognition systems have become a popular purchase for departments of motor vehicles (DMVs) across the country. The benefit of suppressing identity fraud among driver's license applicants is offset, though, by the fact that DMVs are collecting digital images of each face. In the near future, these images may be used to identify people, and thus track them, using the camera systems that are increasingly networked across cities and towns. In similar fashion, license plate readers, which are being used in many jurisdictions for law enforcement purposes, also produce records of the movement of every car. By strong inference, that creates records of the movements of every driver.

Several states have signed memoranda of understanding (MOUs) with the Federal Bureau of Investigation (FBI) for the purpose of participating in the so-called Next Generation Identification initiative. The NGI's ostensible goal is to expand the capabilities of the Integrated Automated Fingerprint Identification System, the FBI's national fingerprint check system, by integrating additional biometrics such as facial imaging, palm

prints, and iris scans. The enhanced system serves a legitimate purpose in law enforcement, and the NGI is designed to expand its capabilities. But like other such systems, it may one day be used as a national identity repository, housing identity data on all Americans.

In the absence of federal immigration reform, a number of states have mandated the use of the E-Verify program by businesses and government contractors in their state. E-Verify checks the information supplied by new employees against federal government databases. The program is already beginning to integrate photos and state data about licensed drivers; its trajectory is to create a national ID that allows the government to perform background checks not just on every new worker, but conceivably on everyone seeking health care or picking up a prescription, cashing a check, using a credit card, applying for rental housing or a home purchase, buying a gun or ammunition, and so on. States participating in the RIDE program share data about their drivers with the federal E-Verify system so it can be part of new workers' background checks.

Creating an accurate and reliable system for verifying employment eligibility under the current immigration laws would require a national identification system, costing about $20 billion to create and hundreds of millions more per year to operate. Immigration reform legislation considered in summer 2007 would have required *all* Americans to have a so-called REAL ID card to get work (see below). This demonstrates the tight link between internal enforcement of immigration law and national ID proposals.

Whether assembled separately, one piece at a time, by states complying with federal dictates or seeking minor security gains, or assembled in one act by the federal government, the end-point of these efforts is a single system for tracking and control: a national ID. The most explicit effort to create a national ID thus far is the REAL ID program.

The REAL ID Program

In the wake of the terrorist attacks on 9/11, the idea of a national ID system gained currency. Among many interest groups and organizations poring over the problem of terrorism was a group called the Markle Foundation Task Force on National Security in the Information Age. One of the task force's reports contained an appendix titled “Reliable Identification for Homeland Protection and Collateral Gains,” which endorsed a national ID system. That recommendation was cited in a short section of the 9/11 Commission's final report to support the assertion

that the federal government should take steps to secure the country's identity systems. Congress passed legislation responsive to this part of the 9/11 Commission Report in 2004's Intelligence Reform and Terrorism Prevention Act.

The following year, Congress passed the REAL ID Act without a hearing in either the House or the Senate by attaching it to a military spending bill. REAL ID repealed the earlier-passed legislation on identity security, attempting to create a national ID system instead. REAL ID seeks to coerce states into issuing their driver's licenses and identification cards according to national standards and requirements, including distinguishing between citizens and noncitizens. And it requires states to share driver information nationwide through a network of databases. REAL ID threatens to refuse the residents of noncompliant states at Transportation Security Administration (TSA) airport checkpoints when they go to travel.

Given the many defects of the REAL ID Act, state legislatures across the country originally passed resolutions and legislation objecting to the law or outright barring their own implementation of the act's provisions. When the original May 2008 compliance deadline approached, the Department of Homeland Security gave deadline extensions to states just for the asking. It even gave extensions to states that didn't ask for them, states whose leaders went out of their way to thumb their noses at the department. But in the years since REAL ID's passage, the Department of Homeland Security has worked to erode state resistance to the program. Many states continue to move toward REAL ID compliance in fits and starts.

Implementation of REAL ID would provide negligible national security gains at a significant cost in terms of personal privacy, power, and heightened risk of identity fraud. While state leaders resist implementation, Congress should spend no more funds on implementing REAL ID and should repeal the REAL ID Act.

Diverse and Competitive Private Identification and Credentialing

Rather than focus on government-issued ID cards, federal and state policy should encourage and foster the variety of identification and credentialing systems in the private marketplace today, as well as those that can be developed. People carry many types of privately issued identification cards and credentials that provide as good or greater security and identity assurance than government-issued cards. For example, many people carry credit cards that allow them to pay for goods or services securely. A variety

of privately issued access cards and devices, including phones, allow people entry to buildings or access to automobiles, health care, and so on.

State and federal governments should not insist on particular issuers' cards (i.e., their own government-issued ID). Instead, they should accept (and allow acceptance of) any card or device that provides sufficient proof of the information necessary for a given transaction. For example, many state laws require people buying alcohol to be at least 21 years old. But they don't allow just any sufficient proof of age; they require presentment of government-issued ID, including all the data that are extraneous to proving a person's age, including name, address, weight, eye color, and so on. As cards are scanned more and more often, these policies will needlessly cause tracking of law-abiding citizens that degrades their privacy.

In a marketplace for identification services, consumers should be able to choose which methods they use to identify themselves or prove relevant credentials like age; how much information they share for this purpose; and whether records of their activities are kept. Having a national ID would tend to deprive Americans of such choices.

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—Prepared by Jim Harper

22. Restoring the Right to Keep and Bear Arms

Congress should

- compel Washington, D.C., to abide by the principles established in the *Heller* decision;
- repeal the federal ban on interstate purchases of handguns;
- revoke the federal age minimums on buyers and possessors of handguns and long guns;
- amend federal law to allow firearm purchases by users of controlled substances, particularly in states that have legalized medical or recreational marijuana;
- resist onerous and ineffective proposals for universal background checks on firearms sales and loans;
- modernize and improve the operations at the Bureau of Alcohol, Tobacco, Firearms and Explosives and revoke the executive branch's authority to use the Arms Export Control Act to impose gun control;
- restore funding to process "relief from disability" applications to own firearms; and
- ensure that secret government lists—such as the "no-fly" list—are not used to unconstitutionally deprive citizens of their Second Amendment rights.

It has been almost 10 years since the Supreme Court decided *District of Columbia v. Heller*, which affirmed that the Second Amendment secures an individual right to keep and bear arms. Two years later, in *McDonald v. Chicago*, the Court incorporated that right to the states, ensuring that the Second Amendment now protects citizens from onerous firearm regulations passed by federal, state, or municipal governments.

Many people predicted that, after *Heller* and *McDonald*, the Court would soon hear more Second Amendment cases to clarify what sort of firearm regulations violate the right to keep and bear arms. For example, can states prohibit carrying weapons, or do magazine size restrictions violate the Second Amendment? Yet, although some lower federal courts have opined on these and other questions, the Supreme Court has stubbornly resisted hearing more Second Amendment cases.

Nevertheless, within the *Heller* framework, Congress now has a historic opportunity to begin restoring Americans' right to keep and bear arms. To be sure, Cato Institute scholars have opposed previous congressional meddling in the gun control arena on the ground that most federal regulations of firearms are not authorized under the Interstate Commerce Clause. That clause was intended to ensure the free flow of trade across state lines, not to sanction a federal police power. Regrettably, the battle to limit the interstate commerce power to interstate commerce seems to have been lost in the courts, which have expanded the scope of the Commerce Clause to cover regulation of nearly anything and everything. But there can be no constitutional objection to repealing laws—or, at a minimum, amending their most egregious provisions—that had no constitutional pedigree in the first place. The same logic applies, of course, to laws that offend the Second Amendment.

Indeed, even if a federal gun law were constitutionally authorized, that does not mean it would be constitutionally mandated. Accordingly, included in what we propose below are recommendations to repeal or amend statutes that are misguided on public policy grounds and that may also be infringements of the Second Amendment.

Compel Washington, D.C., to Abide by the Principles Established in the Heller *Decision*

Few jurisdictions in the United States worked as doggedly to disarm citizens as did the District of Columbia, our nation's capital and, in the 1990s, the "murder capital." Until the *Heller* decision, no handgun could be registered in D.C. Even those handguns grandfathered in before the District's 1976 ban could not be carried from room to room in the home without a license, which was never granted. In addition, all firearms in the home, including rifles and shotguns, had to remain unloaded and either disassembled or bound by a trigger lock. In effect, no one in the District could possess a functional firearm in his or her own residence. And the law applied not just to "unfit" people like felons or the mentally

incompetent, but across the board to ordinary, honest, responsible citizens. Happily, the Supreme Court ruled that all those provisions violate the personal and private right to keep and bear arms that is secured by the Second Amendment.

Today, D.C. still has some of the most stringent gun laws in the country. All firearms must be registered, and those seeking a permit must be at least age 21 (for a handgun) and pass an online training course and a background check. There is also a 10-round magazine limit, which is constitutionally dubious. Pistols and rifles that come with standard magazines that hold more than 10 rounds are commonly used for lawful self-defense and sport, including the popular Beretta Model 92 pistol (standard 16-round magazine) and the AR-15 rifle (standard 20-round magazine). Aside from the doubtful contributions to public safety—very few, if any, acts of violence depend upon having more than 10 rounds in a magazine—the "common use" test articulated in *Heller* casts doubt on the constitutionality of laws prohibiting these weapons.

As of this writing, the U.S. District Court for the District of Columbia ruled unconstitutional the "good cause" provision of D.C.'s carry permit system, which requires those seeking a permit to carry a gun to show a "good reason to fear injury to his or her person or property." The government asked for and received a stay from the U.S. Court of Appeals for the D.C. Circuit, essentially reinstating the good cause provision until the D.C. Circuit can hear the appeal.

Yet Congress does not need to wait for the judicial process to work itself out. Under Article I, Section 8 of the Constitution, Congress can and should exercise its plenary power over all legislative matters in the nation's capital and compel the city to abide by the principles established in the *Heller* decision. Home rule, arising out of authority delegated by Congress to the D.C. government, is not a license to violate the Constitution.

For starters, Congress should enact legislation to alter how D.C. processes gun registrations. A streamlined registration process would be based on the congressionally created National Instant Criminal Background Check System, which is mandatory for all retail firearm sales in the United States. The system uses computerized databases to complete a background check within a few hours in most cases.

Congress should also repeal D.C.'s magazine restriction, remove the discretionary "good cause" requirement for a carry permit to convert the District into a "shall issue" jurisdiction for permits, and relax the constraints

on starting and maintaining gun stores. Currently, it is nearly impossible to open a gun store in D.C., and there is only one licensed dealer in the city. The dealer, who operates by appointment only in an office in police headquarters, doesn't even sell guns—he merely acts as a middleman for those who want to transfer guns to the District and charges $125 for his service. A gun store and range is set to open in the District by 2017, but the process has been arduous and the proposed store will still face unreasonable restrictions. Gun stores can operate only in "C-2" zoned areas, and they cannot be within 300 feet of "(1) a residence or Special Purpose District; or (2) a church or other place of worship, public or private school, public library or playground," which leaves very few available spaces.

There have been beneficial changes since 2008, some through legislation and some through court victories. But the D.C. government is still hostile to its citizens exercising their Second Amendment rights. Congress can and should fix this.

Repeal the Federal Ban on Interstate Purchases of Handguns

Under federal law, a person who is not a licensed dealer—that is, a Federal Firearms Licensee (FFL)—may acquire a handgun only within the person's own state. The acquirer may, however, purchase the handgun from an out-of-state FFL, providing an arrangement is made for the handgun to be shipped to an FFL in the purchaser's state of residence, where the purchaser can then obtain the handgun after complying with all necessary background checks. That rule does not apply to rifles and shotguns. A buyer may acquire a rifle or shotgun, in person, at a licensee's premises in any state, provided the sale complies with laws applicable in both the state of sale and the state where the purchaser resides. So a person who resides in New Mexico can buy a shotgun from a licensed firearms dealer in South Dakota (who must, by federal law, get prior approval for the sale from the National Instant Criminal Background Check System). The New Mexican can then bring the gun home to New Mexico, in compliance with New Mexico law.

There is no persuasive reason why the framework applicable to rifles and shotguns should not be equally applicable to handguns. No relevant state laws would be violated, and all background checks would be completed. In short, Congress should repeal the federal restrictions on interstate handgun sales.

The unique situation in Washington, D.C., compels timely action. Because of the District's 1976 ban, there are currently no stores within the city where a handgun can be obtained, and there is only one FFL willing to take delivery from out-of-city parties, on a limited basis. Thus, it is incredibly difficult for someone who lives in D.C. to acquire a handgun either inside or outside the city. Residents of the city who do not own a handgun are seriously impaired from exercising the right, guaranteed by the Constitution and affirmed by the Supreme Court, to defend themselves within their homes.

In February 2015, the U.S. District Court for the Northern District of Texas struck down the interstate purchase ban as violating the Second and Fifth Amendments (because, by discriminating on the basis of residency, the law has been held to violate the equal protection component of the Due Process Clause). The plaintiffs in the case are a Texas FFL and a couple who live in D.C. The government appealed the decision to the Fifth Circuit, where a decision is still pending.

Revoke the Federal Age Minimums on Buyers and Possessors of Handguns

Under current federal law, the minimum age at which prospective buyers can acquire a handgun from an FFL is 21. The minimum age at which anyone can possess a handgun, or purchase a rifle or shotgun from an FFL, is 18. Those restrictions should be repealed. That is not to say there should be no minimum purchase age. But, assuming that bans on the sale of a handgun to a 20-year-old, or possession of a handgun by a 17-year-old, could survive Second Amendment scrutiny, then state, not federal, law should address that topic. Similarly, states have varying minimum ages for the purchase of tobacco, but a federal minimum would be inappropriate.

Although the federal statute includes some exceptions—for example, a parent may take a child target shooting—it nonetheless usurps traditional state powers, is overbroad, and encroaches on parental rights. Even if a child is under direct and continuous parental supervision, the parent commits a federal crime unless he or she writes a note giving the child permission to target shoot and the child always carries the note. Congress should abolish federal age limits, leaving the states to set their own policies—with due regard to a paucity of empirical evidence that federal age limits have reduced gun accidents or criminal violence.

Amend Federal Law to Allow Firearm Purchases by Users of Controlled Substances, Particularly in States That Have Legalized Medical or Recreational Marijuana

Federal law, under 18 U.S.C. §922(d), currently lists a wide variety of people who are prohibited from purchasing a firearm. Many of these are sensible (felons, fugitives from justice), but many are not. Of particular concern are prohibitions affecting people who are not inherently violent or dangerous. As the Supreme Court held in *Heller*, the right to keep and bear arms is fundamental, and Congress should be wary of taking away that right from entire classes of nonviolent people.

As of November 2016, adults can now legally purchase and consume marijuana in eight states. Nevertheless, federal law still classifies marijuana as a Schedule 1 drug, thus making marijuana simultaneously legal and illegal in states that have already legalized it or will do so in the future. That puts marijuana users in those states in a difficult spot when it comes to purchasing a gun. The federal form they must fill out asks whether they are a user of marijuana. If they say "yes," they will not be able to purchase a gun; if they lie and say "no," they will be committing a felony punishable by up to five years in prison.

Medical marijuana users are also prohibited from purchasing a gun. Twenty-eight states and the District of Columbia now allow medicinal use of marijuana by authorized persons. Becoming an authorized medicinal user often includes registering with a state database or permitting system. That makes the act of lying on the federal form when purchasing a gun even more hazardous.

At the very least, Congress should remove from the list of prohibited persons marijuana users in those states that have legalized either medicinal or recreational use. Yet controlled substance users of all types should not have their Second Amendment rights taken from them. Drug users with no history of violent crime still have a right to self-defense. State laws can appropriately address the issue, as they do with alcohol; for example, a person's demonstration of dangerous lack of self-control when under the influence (e.g., multiple drunk driving convictions) can lead to revocation of a handgun carry permit.

Resist Onerous and Ineffective Proposals for Universal Background Checks on Firearms Sales and Loans

In recent years, calls for "universal background checks" on all firearms purchases have received a lot of attention. Various bills have been intro-

duced, but none has yet been able to pass. Congress should be aware that expanding background checks is unlikely to affect the gun-violence rate, and many bills requiring universal background checks suffer from severe problems that could turn nearly every gun owner into a felon.

Federal law currently requires all firearms dealers to be FFLs and, among other things, requires a background check on every buyer to whom they sell a firearm. Yet no background check is required when a sale occurs between two private individuals. In other words, you can sell your neighbor your hunting rifle without doing a background check on your neighbor.

There is some dispute about how many guns are transferred via this so-called private sale loophole. President Barack Obama and other gun-control advocates have consistently and irresponsibly claimed that the number is 40 percent. That claim, which relies on data that is two decades old and predates the inauguration of our current background check system, was given "three Pinocchios" by the fact checkers at the *Washington Post*. Other, more accurate studies have found nonbackground-check purchases to be around 20 percent of gun sales—and many of those are gifts between family members.

Surveys of criminals have long indicated that their guns are rarely obtained through legal avenues. Instead, the black market is the overwhelming source for guns used in crimes. That makes sense: criminals are unlikely to submit to a background check process, which they are likely to fail. Therefore, most criminals acquire guns in unlawful ways. Most important, if new laws are enacted that prohibit certain types of sales without background checks, criminals will adjust and find new methods for obtaining guns.

Nevertheless, it is also overreaching to say that background checks will never help keep guns away from any criminal. There will always be marginal criminals who are weakly motivated to acquire a gun. But the effectiveness of expanding background checks depends upon a truly rare combination of conditions: (1) a law-abiding seller who does not wish to sell to a criminal; (2) a seller who fears getting caught if he doesn't perform the required background check; (3) a buyer who is prohibited from acquiring a gun; (4) a buyer who is willing to submit accurate information about himself to a background check; and (5) a buyer who cannot acquire the gun elsewhere. Such a confluence of conditions might occasionally exist, but any rare benefit would be outweighed by false positives, which deny legitimate purchasers their Second Amendment rights.

Further, Greg Ridgeway, acting director of the National Institute of Justice, acknowledged in a 2013 memorandum that requiring background

checks for gun sales by non-FFLs would be unenforceable without universal gun registration. Such a gun registry would be contrary to the Firearm Owners' Protection Act and other provisions of federal law. The prohibitions on federal gun registration exist because Congress recognized that registration sets the stage for confiscation. For example, New York City's registration is currently being used to confiscate rifles and shotguns that hold more than five rounds of ammunition.

Universal background check proposals at the federal and state level are Trojan horses that criminalize ordinary activities having nothing to do with firearms sales. At minimum, any proposed federal bill should be heavily scrutinized to ensure that it doesn't produce the absurd consequences of state universal background check laws.

In Washington State—which has enacted one version—the normal, everyday practices of gun owners, safety instructors, hunters, and even museums have been turned into felonies. Even harmless firearms transfers, such as giving a rifle to a friend at a backyard shooting range, are prohibited without first processing the transfer through an FFL. That is because the state of Washington defines a "transfer" as "the intended delivery of a firearm to another person without consideration of payment or promise of payment including, but not limited to, gifts and loans." The Washington law applies not only to permanent but also to temporary and even momentary transfers.

Or imagine that the owner of a farm has invited a friend over for some target shooting on the man's farm. He wishes to lend a rifle to his friend for the afternoon. Under Washington's universal background check law, the owner and the friend must first travel to a gun store. There, the FFL will process the loan as if he is selling a firearm out of his own inventory. Thus, state universal background check laws can require lenders to fill out federal paperwork consisting of dozens of questions (including offensive and irrelevant ones, such as the friend's race and whether the friend is Hispanic). A knowingly false answer is a federal crime punishable by up to five years in prison. Filling out the form in a manner not approved by the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) (such as writing one's state of residence as "Wash." rather than "WA") will get the store in trouble with the ATF. So store clerks understandably spend a lot of time making sure that customers fill out the paperwork correctly. Of course the store charges a fee for the service, since all the time spent processing the loan is time not spent selling the store's own firearms. On top of the store's fee, the state government may collect its own fee for conducting the background check.

Even worse, a few hours later, after the farmer and his friend are finished with an afternoon of target shooting, they must return to the gun store. The whole process must be repeated, with a new round of paperwork and fees. This time, the store will process the return of the loaned gun to its owner as if the owner were buying a new gun from the store's inventory. Imposing this process on firearms loans is pointless and bureaucratic. It also makes firearms loans impossible except during hours when there is a nearby gun store that is open and is willing to process the transaction. Many stores refuse to do so, since they want their employees to spend time on selling their own inventory, rather than on risking liability for paperwork errors involving other people's guns.

The extreme burdens on firearms loans can be deadly. Universal background check laws make it impossible for a person to lend a firearm to a woman who is being threatened by an ex-boyfriend, if the threat arises on a Saturday night, when gun stores are closed. (Most background check proposals only allow defensive firearms loans when the threat is "immediate"—and not for cases when a stalker might attack in an hour, or next week, or the next month.)

The absurdly overbroad controls on loans criminalize most gun owners for innocent activity. They are particularly problematic for gun safety instructors, who pass guns back and forth between themselves and students while teaching safety courses; for people in rural areas who may live hours away from any gun store; and even for museums that may wish to display guns but cannot obtain, move, or clean them without submitting to a background check. Colorado amended its universal background check law to exempt all temporary transfers of less than 72 hours. That made the law more sensible but did not solve all the problems. Someone who wishes to store his gun at his cousin's house while he spends two years in the Peace Corps, for example, would need a background check on his cousin and then another on himself when the gun is returned.

Some think that people would never be prosecuted for these minor infractions, even if they are "technically" illegal. But relying on the restraint of federal prosecutors is never a good idea. Gun owners are constantly prosecuted for similar, or even smaller, transgressions. In one example, in 2002, John Mooney seized a firearm from his ex-wife when she, while intoxicated, pointed it at his head. He then walked seven blocks to the bar where he worked to hand the weapon over to the police. Because Mooney was a convicted felon, however, he was charged with the unlawful possession of a firearm.

Even if a universal background check law were a good idea, *it should apply only to sales and permanent dispositions*; loans and returns should be exempted. And every effort should be made to reduce the burden on gun buyers—including fees, paperwork, and trips to gun stores.

Furthermore, law enforcement officers and those who already hold concealed carry permits issued by their state should not have to undergo additional background checks when they purchase a gun from a private seller. Nor should it be criminal for law enforcement officers to return stolen guns to crime victims or for campus police offices to store hunting guns owned by students. Concealed carry permit holders typically have submitted to biometric identity verification, background checks, and safety training. Making them go to a gun store for a lower-quality background check when they borrow a gun, or buy one from a friend, is duplicative and unnecessary.

There are many ways to accomplish background checks without requiring that a seller and a buyer find a gun store to carry one out. Private citizens should be able to accomplish any required background check by contacting the appropriate state agency through the phone or the Internet. Any universal background checks bill that really aims for background checks on gun sales—rather than the mass criminalization of innocent gun owners—will contain all of the above exceptions. And, finally, it should be noted that proposals for universal background checks distract Congress from the more meaningful debate about policy changes that could significantly lower gun violence, such as ending the drug war.

Modernize and Improve ATF Operations and Revoke the Executive Branch's Authority to Use the Arms Export Control Act to Impose Gun Control

Abusive practices by the Bureau of Alcohol, Tobacco, Firearms and Explosives led Congress to enact the Firearms Owners' Protection Act in 1986. Yet much more needs to be done. For example, when the ATF imposes a penalty on a gun store, the store should be able to appeal the case to a neutral administrative law judge. Currently, an employee of the ATF itself hears appeals of ATF penalties.

Appropriations riders have prevented the ATF from using gun dealer records to compile a computerized national registration database of gun owners. That prohibition should be part of a permanent statute. Federal law already prohibits the creation of a national gun registry, but the ATF has claimed that a computerized database of every sale ever conducted by

every retired FFL is not a national gun registry. Other appropriations riders protect citizen privacy by preventing the ATF from disclosing gun-tracing data (e.g., the name and address of a person whose gun is stolen) to the general public. The data can still be disclosed in connection with a bona fide law enforcement investigation. Those disclosure rules should be permanently codified as well.

The ATF's firearms-testing facility has long been a subject of concern. ATF employees who conduct tests on firearms are not required to have expertise in forensics or other procedures appropriate to a crime laboratory. To support prosecutions for machine-gun possession, ATF testers have been known to use one ammunition type after another until they find one that occasionally makes the firearm malfunction by producing two shots from a single trigger pull. A jury will then see an official ATF report declaring that the gun is a machine gun. Congress should require that all ATF firearms testing be filmed and the films be preserved.

Federal law has long required licenses for persons who commercially manufacture firearms and for persons who engage in the business of gunsmithing. The licenses are issued by the ATF. In July 2016, the Obama administration issued "guidance" requiring many gunsmiths to obtain a separate license, costing $2,500, from the Department of State, Directorate of Defense Trade Controls. Supposedly, these licenses are necessary for compliance with the Arms Export Control Act, but the administration is requiring them from people who never export anything. Under the new directive, the one-time performance of simple activities such as adding a two-round magazine extender to a five-round shotgun, or drilling a sight mount on a handgun to improve its accuracy, constitute "manufacturing" and thus require the $2,500 Arms Export Control Act license. Many of the supposed "manufacturing" activities are often performed by ordinary gun owners to improve their own firearms. Congress should revoke the executive branch's supposed authority to impose domestic gun control in the guise of regulations or guidance under the Arms Export Control Act.

Restore Funding to Process "Relief from Disability" Applications to Own Firearms

The federal prohibitions on firearms possession are extremely broad and ex post facto. The Gun Control Act of 1968 banned gun possession by anyone convicted of a felony or dishonorably discharged from the military. Thus, a person who pleaded guilty to a tax offense in 1959, or who was dishonorably discharged in 1965 because of homosexual

orientation, is barred for life from possessing a gun. The 1994 ban on gun possession by someone guilty of a domestic violence misdemeanor is also ex post facto—applying to people who might have pleaded guilty decades earlier, even if they had done nothing wrong but could not afford a lawyer and found it simpler to resolve the case for a $50 fine.

To provide a safety valve for the expansive bans, the Gun Control Act allows "relief from disability." People who can prove they have a long record of law-abiding behavior and good conduct can petition ATF for restoration of their Second Amendment rights. Granting a petition is entirely at the discretion of the ATF. Since 1992, appropriations riders have forbidden ATF from processing petitions for restoration of rights. Those riders should end, and ATF should be directed to set up a process in which such petitions are funded by a fee charged to the petitioner.

Federal law also bans gun possession by people subject to temporary restraining orders. The law should be clarified so that it applies only to cases where a judge has made a particularized finding that a person has threatened, or constitutes a threat to, another person. Routine orders directing one or both parties in a divorce to stay away from and not harm each other should not be the basis for deprivation of a constitutional right. The change can be effectuated by changing the word "or" to "and" in 18 U.S. Code § 922(d)(8)(B)(i) and in (g)(8)(C)(i).

Ensure that Secret Government Lists—Such as the No-Fly List—Are Not Used to Unconstitutionally Deprive Citizens of their Second Amendment Rights

Recently, many have called for the federal government to prohibit those on the no-fly list from purchasing firearms. Not only should this be resisted, it should be seen as setting a dangerous precedent for the government stripping citizens of constitutionally enumerated rights by secretly placing them on government-maintained lists.

The no-fly list has been called a "Kafkaesque bureaucracy" by the American Civil Liberties Union. The list is secretive, unaccountable, and discriminatory. Someone can be listed based on suspicion or hunch; according to the government's guidelines for adding people to the list, "irrefutable evidence or concrete facts are not necessary." In 2014, a federal district court ruled that dooming an individual to indefinite placement on the list violates due process.

According to the Associated Press, more than 1.5 million names have been added to the list, and subsequent reporting found that half of those

were marked as having "no recognized terrorist group association." The Council of American-Islamic Relations has filed a class action lawsuit alleging that the list is discriminatory against Muslims.

During the Bush administration, Rep. Sheila Jackson-Lee (D-TX) chaired a hearing on the terror watch list and worried that it would catch people who "innocently come to use the airlines and to visit Grandma, to go on a family vacation, to try to make deadlines to a funeral, and whatever else the airlines are used for." Rep. Yvette Clarke (D-NY) has said that "with so many different names on the list, it is not surprising that every single day countless Americans are misidentified as terrorists." Despite these reservations, both representatives participated in the June 2016 "sit-in" on the floor of the House, partially in protest of the failure of "no-fly, no-buy" legislation.

On top of these concerns, a "no-fly, no-buy" law would have no effect on mass shootings or terrorist attacks. Even if they appeared on the list, and it is highly unlikely they would, terrorists and mass shooters are highly motivated criminals who are not deterred by being told "no" at a gun store because their name appears on a "no-buy" list. Such laws are political theater at its finest—scoring solid points on rhetoric while doing nothing to solve the problem—while setting a dangerous precedent for eliminating civil liberties through government-maintained secret lists.

Conclusion

The Second Amendment secures "the right of the people" by guaranteeing the right of each person. Over the years, our elected representatives have adopted a dangerously court-centric view of the Constitution: a view that decisions about constitutionality are properly left to the judiciary. But members of Congress also swear an oath to uphold the Constitution. Congress can make good on that oath by legislating to restore our right to keep and bear arms.

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—Prepared by Trevor Burrus, David B. Kopel, and Robert A. Levy

23. The War on Drugs

Congress should

- repeal the Controlled Substances Act of 1970;
- direct the administration not to interfere with the implementation of state initiatives that allow for the recreational or medical use of marijuana;
- repeal the federal mandatory minimum sentences; and
- shut down the Drug Enforcement Administration.

Ours is a federal republic. The federal government has only the powers granted to it in the Constitution. And the United States has a tradition of individual liberty, vigorous civil society, and limited government. Identification of a problem does not mean that the government should undertake to solve it, and the fact that a problem occurs in more than one state does not mean that it is a proper subject for federal policy.

Perhaps no area more clearly demonstrates the bad consequences of not following such rules than does drug prohibition. The long federal experiment in prohibition of marijuana, cocaine, heroin, and other drugs has given us crime and corruption combined with a manifest failure to stop the use of drugs or reduce their availability to children.

In the 1920s, Congress experimented with the prohibition of alcohol. On February 20, 1933, a new Congress acknowledged the failure of alcohol prohibition and sent the Twenty-First Amendment to the states. Congress recognized that Prohibition had failed to stop drinking and had increased prison populations and violent crime. By the end of 1933, national Prohibition was history, though many states continued to outlaw or severely restrict the sale of liquor.

Today, Congress must confront a similarly failed prohibition policy. Futile efforts to enforce prohibition have been pursued even more vigorously since the 1980s than they were in the 1920s. Total federal expendi-

tures for the first 10 years of Prohibition amounted to $88 million—about $1 billion in 2015 dollars. Now, drug enforcement costs about $27 billion a year in federal spending alone.

Those billions have had some effect. Total drug arrests are now more than 1.5 million a year. Since 1989, more people have been incarcerated for drug offenses than for all violent crimes combined. There are about 300,000 drug offenders in jails and prisons, and 50 percent of the federal prison population consists of drug offenders.

Yet, as during Prohibition, all the arrests and incarcerations haven't stopped the use and abuse of drugs, or the drug trade, or the crime associated with black-market transactions. Cocaine and heroin supplies are up; the more our Customs agents interdict, the more smugglers import.

As for discouraging young people from using drugs, the massive federal effort has largely been a dud. Every year from 1975 to 2012, at least 82 percent of high school seniors said they found marijuana "fairly easy" or "very easy" to obtain. During that same period, according to federal statistics of dubious reliability, teenage marijuana use fell dramatically and then rose significantly, suggesting that cultural factors have more effect than the "war on drugs."

Repeal the Controlled Substances Act

The United States is a federal republic, and Congress should deal with drug prohibition the way it dealt with alcohol prohibition. The Twenty-First Amendment did not actually legalize the sale of alcohol; it simply repealed the federal prohibition and returned to the states the authority to set alcohol policy. States took the opportunity to design diverse liquor policies that were in tune with the preferences of their citizens. After 1933, three states and hundreds of counties continued to practice prohibition. Other states chose various forms of alcohol legalization.

The single most important law that Congress must repeal is the Controlled Substances Act of 1970. That law is probably the most far-reaching federal statute in American history: it asserts federal jurisdiction over every drug offense in the United States, no matter how small or local in scope. Once that law is removed from the books, Congress should move to abolish the Drug Enforcement Administration and repeal all the other federal drug laws.

There are a number of reasons why Congress should end the federal government's war on drugs. First and foremost, the federal drug laws are constitutionally dubious. As noted, the federal government can exercise

only the powers that have been delegated to it. The Tenth Amendment reserves all other powers to the states or to the people. However misguided the alcohol prohibitionists turned out to have been, they deserve credit for honoring our constitutional system by seeking a constitutional amendment to explicitly authorize a national policy on the sale of alcohol. Congress never asked the American people for additional constitutional powers to declare a war on drug consumers. That usurpation of power is something that few politicians or their court intellectuals wish to discuss.

Second, drug prohibition creates higher levels of crime. Addicts commit crimes to pay for a habit that would be easily affordable if it were legal. Police sources have estimated that as much as half of the property crime in some major cities is committed by drug users. More dramatically, because drugs are illegal, participants in the drug trade cannot go to court to settle disputes, whether between buyer and seller or between rival sellers. When black-market contracts are breached, the result is often some form of violent sanction, which usually leads to retaliation and then open warfare in the streets.

Make no mistake, the annual carnage from gang violence has little to do with the mind-altering effects of a marijuana cigarette or a meth pipe. It is instead one of the grim and bitter consequences of an ideological crusade whose proponents will not yet admit defeat.

Third, U.S. intelligence officials have repeatedly warned us of possible terrorist attacks. Given that danger, it is a gross misallocation of law enforcement resources to have federal police agents looking for marijuana fields when they could be helping to discover terrorists on U.S. territory. The Drug Enforcement Administration has 10,000 agents, intelligence analysts, and support staff members. Their skills would be much better used if they were redeployed to full-time counterterrorism investigations or recruited into local police departments to work unsolved murder and rape cases.

Fourth, drug prohibition is a classic example of throwing money at a problem. The federal government spends some $27 billion to enforce the drug laws every year—all to no avail. For years, drug war bureaucrats have been tailoring their budget requests to the latest news reports. When drug use goes up, taxpayers are told the government needs more money so that it can redouble its efforts against a rising drug scourge. When drug use goes down, taxpayers are told that it would be a big mistake to curtail spending just when progress is being made. Good news or bad, spending levels must be maintained or increased.

Fifth, drug prohibition channels more than $40 billion a year into a criminal underworld that is occupied by an assortment of criminals, corrupt politicians, and terrorists. Alcohol prohibition drove reputable companies into other industries or out of business altogether, which paved the way for mobsters to make millions in the black market. If drugs were legal, organized crime would stand to lose billions of dollars, and drugs would be sold by legitimate businesses in an open marketplace.

Sixth, drug prohibition has exacerbated racial tensions in America. The immense profits to be had from a black-market business make drug dealing the most lucrative endeavor for many young minority men. Drug dealers become the most visibly successful people in inner-city communities, the ones with money and clothes and cars. Social order is turned upside down when the most successful people in a community are criminals. Even though most will end up in prison, the money tempts many young men away from seeking lower-paying legal employment. Since the police are tasked with combating the drug trade, they constantly clash with the residents in minority neighborhoods.

Students of American history will someday ponder the question of how today's elected officials could readily admit to the mistaken policy of alcohol prohibition in the 1920s but recklessly pursue a policy of drug prohibition. Indeed, the only historical lesson that recent presidents and Congresses seem to have drawn from Prohibition is that government should not try to outlaw the sale of booze. One of the broader lessons that they should have learned is this: prohibition laws should be judged according to their real-world effects, not their promised benefits. If the 115th Congress subjects the federal drug laws to that standard, it will recognize that the drug war is not the answer to problems associated with drug use.

Respect State Initiatives

The failures of drug prohibition are becoming obvious to more and more Americans. In 2012, voters in Colorado and Washington approved ballot initiatives that legalized marijuana for recreational purposes. In 2014, voters in Alaska, Oregon, and the District of Columbia approved similar measures. Several more states—California, Massachusetts, Maine, and Nevada—followed suit in the fall of 2016.

A particularly tragic consequence of the war on drugs has been the refusal to allow sick people to use marijuana as medicine. Prohibitionists insist that marijuana is not good medicine, or at least that legal alternatives

to marijuana are equally good. Those who believe that individuals should make their own decisions, not have their decisions made for them by Washington bureaucracies, simply say that that's a decision for patients and their doctors to make. But in fact there is good medical evidence of the therapeutic value of marijuana—despite the difficulty of doing adequate research on an illegal drug. A National Institutes of Health panel concluded that smoking marijuana may help treat a number of conditions, including nausea and pain. It can be particularly effective in improving the appetite of AIDS and cancer patients. The drug could also help people who fail to respond to traditional remedies.

More than 70 percent of U.S. cancer specialists in one survey said they would prescribe marijuana if it were legal; nearly half said they had urged their patients to break the law to acquire the drug. In 2013, Dr. Sanjay Gupta, the chief medical correspondent for CNN, apologized to his viewers for previously voicing his opposition to medical marijuana without having done his own homework. He admitted that he had basically assumed that the Drug Enforcement Administration had sound scientific proof that marijuana could not benefit persons who are ill. After studying the subject more thoroughly, Gupta said, "We have been terribly and systematically misled for nearly 70 years in the United States, and I apologize for my own role in that."

The most relevant point for federal policymakers is that 29 states have authorized physicians licensed in those states to recommend the use of medical marijuana to seriously ill and terminally ill patients residing in the states, without being subject to civil and criminal penalties.

If it is inappropriate for governors and mayors to entangle themselves in foreign policy—and it is—it is also inappropriate for federal officials to entangle themselves in state and local politics. In the 114th Congress, Reps. Dana Rohrabacher (R-CA), Steve Cohen (D-TN), Duncan Hunter (R-CA), Thomas Massie (R-KY), Jared Polis (D-CO), Justin Amash (R-MI), and others jointly proposed the Respect State Marijuana Laws Act of 2015, which would have prohibited federal interference with any person acting in compliance with state rules pertaining to the production, possession, or delivery of marijuana. The 115th Congress should enact a similar bill without delay.

One of the benefits of a federal republic is that different policies may be tried in different states. One of the benefits of our Constitution is that it limits the power of the federal government to impose one policy on the several states.

Repeal Mandatory Minimums

The common law in England and America has always relied on judges and juries to decide cases and set punishments. Under our modern system, of course, many crimes are defined by the legislature, and appropriate penalties are defined by statute. However, mandatory minimum sentences and rigid sentencing guidelines shift too much power to legislators and regulators who are not involved in particular cases. They turn judges into clerks and prevent judges from weighing all the facts and circumstances in setting appropriate sentences. In addition, mandatory minimums for nonviolent first-time drug offenders result in sentences grotesquely disproportionate to the gravity of the offenses. Rather than extend mandatory minimum sentences to further crimes, Congress should repeal mandatory minimums and let judges perform their traditional function of weighing the facts and setting appropriate sentences.

Conclusion

Drug abuse is a problem for those involved in it and for their families and friends. But it is better dealt with as a moral and medical problem than as a criminal problem—"a problem for the surgeon general, not the attorney general," as former Baltimore mayor Kurt Schmoke put it.

Congress should repeal the Controlled Substances Act of 1970, shut down the Drug Enforcement Administration, and let the states set their own policies with regard to currently illegal drugs. They would do well to treat marijuana, cocaine, and heroin the way most states now treat alcohol: it should be legal for stores to sell such drugs to adults. Drug sales to children, like alcohol sales to children, should remain illegal. Driving under the influence of drugs should be illegal.

With such a policy, Congress would acknowledge that our current drug policies have failed. It would restore authority to the states, as the Founders envisioned. It would save taxpayers' money. And it would give states the power to experiment with drug policies and perhaps devise more successful rules.

Repeal of prohibition would take the astronomical profits out of the drug business and destroy the drug kingpins who terrorize parts of our cities. It would reduce crime even more dramatically than did the repeal of alcohol prohibition. Not only would there be less crime: reform would also free federal agents to concentrate on terrorism and espionage and would free local police agents to concentrate on robbery, burglary, and violent crime.

The war on drugs has lasted longer than Prohibition, longer than the Vietnam War. Prohibition has failed, again, and should be repealed, again.

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—Prepared by David Boaz and Timothy Lynch

Government Reform

24. Fiscal Rules That Work

Congress should

- adopt a spending cap to shrink the burden of federal spending and avert a long-run fiscal crisis caused by demographics and entitlements.

For the 2016 fiscal year, federal government spending reached an all-time high of about $4 trillion. That means Washington consumed more than 21 percent of the economy's output. That's higher than the average of less than 19 percent of gross domestic product (GDP) between the end of World War II and 2008 and far above the average of less than 5 percent during America's first 150-plus years.

A rising burden of federal spending means ever-higher tax burdens and ever-larger amounts of government borrowing. A public sector that has grown too large is America's main fiscal challenge. A rising tax burden and growing levels of red ink are symptoms of the underlying disease of big government.

The Need for Long-Run Spending Restraint

Although budget numbers are grim today, the real challenge will be in the future. Because of an aging population and poorly designed entitlement programs, the federal government in the absence of reform is going to get much larger, redistributing greater and greater amounts of national income. The long-run fiscal outlook in the United States is just as bad as it is in many European welfare states. The only difference is that governments in those nations have a head start on the path to economic stagnation and fiscal crisis.

Figuring out how to restrain the growth of government spending is critically important. Fortunately, it shouldn't be that difficult. Even if the

economy is weak, nominal economic output will expand by an average of about 4 percent annually (meaning about 2 percent "real" GDP growth). And that means about 4 percent to 5 percent more tax revenue every year. It's possible to slowly but surely control—and eventually shrink—the burden of federal spending if policymakers simply figure out some way to impose a spending cap so that outlays grow at a modest rate, say 2 percent annually.

Balanced Budget Rules Are Not Successful

When looking at rules to control federal spending, advocates of fiscal responsibility traditionally focused on some form of balanced budget amendment. A well-designed constitutional reform, restricting both red ink and the tax burden, would be a welcome change and could indirectly limit the size of the federal budget. But why focus on the symptom of red ink rather than the underlying problem of excessive spending? Shouldn't the real goal be to directly cap the growth of spending?

Looking at the states, 49 out of 50 have some sort of balanced budget requirement. Those rules have not protected states such as California, Illinois, and New Jersey from either bloated public sectors or large levels of debt. In the European Union, so-called Maastricht rules (also known as the Stability and Growth Pact) were imposed to prevent nations from having budget deficits of more than 3 percent of GDP and overall debt of more than 60 percent of GDP. These rules have not prevented unaffordable welfare states or rising levels of red ink in countries such as France, Italy, and Greece.

It might be possible to tighten these balanced budget rules and impose more effective restrictions on red ink, but that would be a major challenge, particularly in the United States. Constitutional reform here would require two-thirds support in both the House and Senate, followed by support from three-fourths of state legislatures. Given the poor track record of rules that attempt to restrict deficits, it would be better to focus on rules that seek to directly address the real problem of excessive government spending.

The Boom-Bust Cycle and Ratchet Effect

There's a very practical reason to focus on capping long-run spending rather than trying to balance the budget every year. Simply stated, the "business cycle" makes the latter very difficult.

There are two major determinants of tax revenue. The obvious one is the overall tax rate, but the size of the economy (i.e., the tax base) is

equally relevant. A weak economy won't generate much additional tax revenue; a strong economy means that there are more wages to tax and more profits to tax. Thus, when a recession occurs and revenues drop, a balanced-budget mandate requires politicians to make dramatic changes at a time when they are especially reluctant to either raise taxes or impose spending restraint. Then, when the economy is enjoying strong growth and producing lots of tax revenue, a balanced-budget requirement doesn't impose much restraint on spending.

All of which creates an unfortunate cycle. Politicians spend a lot of money during the good years, creating expectations of more and more money for various interest groups. When a recession occurs, the politicians suddenly have to slam on the brakes. But even if they actually cut spending, it is rarely reduced to the level it was when the economy began its upswing. Moreover, politicians often raise taxes as part of these efforts to comply with anti-deficit rules. When the recession ends and revenues begin to rise again, the process starts over—this time from a higher base of spending and with a bigger tax burden. Over the long run, these cycles create a ratchet effect, with the burden of government spending always reaching new plateaus.

Spending Caps

Having some sort of rule to limit annual spending avoids the logistical problems of balanced-budget requirements. A spending cap tells politicians they can increase spending by, say, 2 percent when the economy is in recession. They like that better than a balanced-budget rule that would require actual cuts when revenue is dropping. But a spending cap also tells politicians they can increase spending by only 2 percent when the economy is growing quickly and revenues are rapidly increasing.

The challenge is to design an expenditure rule that works. There are many ways to design a spending cap, including reforms that would limit federal government spending to a certain share of overall economic output (18 percent of GDP, for instance). Scholars at the Mercatus Center have reviewed various rules and found that good results can be achieved with a simple approach that limits spending so it grows no faster than the population plus inflation:

> The effectiveness of [tax and expenditure limits (TELs)] varies greatly depending on their design. Effective TEL formulas limit spending to the

> sum of inflation plus population growth. This type of formula is associated with statistically significantly less spending. TELs tend to be more effective when they require a supermajority vote to be overridden, are constitutionally codified, and automatically refund surpluses. These rules are also more effective when they limit spending rather than revenue and when they prohibit unfunded mandates on local government. Having one or more of these characteristics tends to lead to less spending. Ineffective TELs are unfortunately the most common variety. TELs that tie state spending growth to growth in private income are associated with more spending in high-income states.

Professor Michael New reached a similar conclusion, pointing out that the relatively strict limits in Colorado have been especially effective.

> Why has Colorado's [Taxpayer's Bill of Rights] been more effective than other fiscal limits? . . . Colorado's Taxpayer's Bill of Rights . . . established a limit of inflation plus population growth. . . . [S]trong TELs have been able to restrict government growth. Holding other factors constant, strong TELs annually reduce growth in both state expenditures and state revenues by over $100 per capita.

The Swiss "debt brake," which functionally operates as a spending cap, has also been successful. It is described in a 2011 government report:

> The Swiss "debt brake" or "debt containment rule" . . . combines the stabilizing properties of an expenditure rule (because of the cyclical adjustment) with the effective debt-controlling properties of a balanced budget rule. . . . The amount of annual federal government expenditures has a cap, which is calculated as a function of revenues and the position of the economy in the business cycle. It is thus aimed at keeping total federal government expenditures relatively independent of cyclical variations.

One of the reasons the Swiss brake has been successful is that politicians are constrained from boosting spending during boom years when lots of tax revenue is generated.

> The debt-to-GDP ratio of the Swiss federal Government has decreased since the implementation of the debt brake in 2003. . . . In the past, economic booms tended to contribute to an increase in spending. . . . This has not been the case since the implementation of the fiscal rule, and budget surpluses have become commonplace. . . . The introduction of the debt brake has changed the budget process in such a way that the target for expenditures is defined at the beginning of the process, which must not exceed the ceiling provided by the fiscal rule. It has thus become a top-down process.

The Keynesian Case for Spending Caps

The underlying theory of Keynesian economics is that deficit spending should be increased during a recession to "prime the pump" of the economy. That theory doesn't make much sense since the government can't pour money into an economy unless it first borrows the money out of the economy.

That being said, a spending cap should appeal to Keynesians because it allows federal outlays to increase even during recession years when revenue is falling. Since Keynesians (at least in theory) claim to support surpluses during boom years, they should like the fact that a spending cap limits spending during those periods, thus ensuring that rising revenues will be used to reduce red ink.

Real-World Evidence

The bad news is that very few governments have imposed spending caps. The good news is that there have been very positive results when such policies are in effect. In Hong Kong, Article 107 of the Basic Law (the jurisdiction's constitution) states, "The Hong Kong Special Administrative Region shall . . . keep the budget commensurate with the growth rate of its gross domestic product." This sensible policy helps explain why total government spending averages less than 20 percent of GDP, significantly lower than the total burden of spending in America and far lower than in Europe's welfare states.

In Switzerland, voters used a referendum in 2001 to impose the aforementioned debt brake, which operationally functions as a spending cap. Outlays have expanded by only about 2 percent annually since the constitutional reform was implemented. That restraint has led to a modest reduction in the burden of spending relative to GDP and a big reduction in government debt as a share of economic output.

Even International Bureaucracies Agree

Surprisingly, even organizations such as the International Monetary Fund (IMF) and the Organization for Economic Cooperation and Development (OECD) have concluded that spending caps are the most effective type of fiscal rule. That development is rather remarkable given that these bureaucracies normally have a statist orientation on fiscal policy.

In February 2015, the IMF issued a very favorable assessment of spending caps:

> [E]xpenditure rules have a better compliance record than budget balance and debt rules. . . . The higher compliance rate with expenditure rules is consistent with the fact that these rules are easy to monitor and that they immediately map into an enforceable mechanism—the annual budget itself. Besides, expenditure rules are most directly connected to instruments that the policymakers effectively control. By contrast, the budget balance, and even more so public debt, is more exposed to shocks, both positive and negative, out of the government's control.

Also important, a spending cap imposes discipline during boom years.

> One of the desirable features of expenditure rules compared to other rules is that they are not only binding in bad but also in good economic times. . . . In contrast to other fiscal rules, countries also have incentives to break an expenditure rule in periods of high economic growth with increasing spending pressures. . . . [T]wo design features are in particular associated with higher compliance rates. . . . [C]ompliance is higher if the government directly controls the expenditure target. . . . Specific ceilings have the best performance record.

Another IMF study from March 2015 noted the problem of too much spending during years with robust revenue growth.

> An analysis of stability programs during 1999–2007 suggests that actual expenditure growth in euro area countries often exceeded the planned pace, in particular when there were unanticipated revenue increases. Countries were simply unable to save the extra revenues and build up fiscal buffers. . . . This reveals an important asymmetry: governments were often unable to preserve revenue windfalls and faced difficulties in restraining their expenditure in response to revenue shortfalls when consolidation was needed. . . . The 3 percent of GDP nominal deficit ceiling did not prevent countries from spending their revenue windfalls in the mid-2000s. . . . Noncompliance has been the rule rather than the exception. . . . The drawbacks of the nominal deficit ceiling are particularly apparent when the economy is booming, as it is compatible with very large structural deficits.

So what's the solution? The report says spending caps work.

> [T]he expenditure growth ceiling may seem the most appealing. This indicator is tractable (directly constraining the budget), easy to communicate to the public, and conceptually sound. . . . Based on simulations, Debrun and others (2008) show that an expenditure growth rule with a debt feedback ensures a better convergence towards the debt objective, while allowing greater flexibility in response to shocks. IMF (2012) demonstrates the good performance of the expenditure growth ceiling.

In July 2015, the OECD wrote:

> [T]he adoption of a budget balance rule complemented by an expenditure rule could suit most countries well. . . . [T]he combination of the two rules responds to the two objectives. A budget balance rule encourages hitting the debt target. And, well-designed expenditure rules appear decisive in ensuring the effectiveness of a budget balance rule. Carnot (2014) shows also that a binding spending rule can promote fiscal discipline while allowing for stabilisation policies. . . . Spending rules entail no trade-off between minimising recession risks and minimising debt uncertainties. They can boost potential growth and hence reduce the recession risk without any adverse effect on debt. Indeed, estimations show that public spending restraint is associated with higher potential growth.

The OECD also addressed the issue in a November 2015 report. The highlights here include a warm embrace of the Swiss debt brake:

> The European Union's Stability and Growth Pact . . . proved largely ineffective in protecting countries from the effects of the fiscal crisis. . . . Simple and clear fiscal anchors—e.g., the Swiss and German debt brake rules—appear to have been more effective in influencing effective fiscal management. . . . A combination of a budget balance rule and an expenditure rule seems to suit most countries well. . . . [W]ell-designed expenditure rules appear decisive to ensure the effectiveness of a budget balance rule and can foster long-term growth. . . . Spending rules entail no trade-off between minimising recession risks and minimising debt uncertainties. They can boost potential growth and hence reduce the recession risk without any adverse effect on debt. Indeed, estimations show that public spending restraint is associated with higher potential growth.

In December 2015, the European Central Bank issued a report on fiscal rules. A key point was that deficit-oriented rules don't bind politicians during growth years: "[D]uring a boom phase, fiscal rules do not prevent fiscal policy from turning expansionary." Once again, spending caps got the highest marks.

> Regarding the different types of fiscal rules, we find particularly strong coefficients for expenditure rules, possibly reflecting the fact that expenditure rules are easier to monitor and are thereby more credible. . . . If a country had a fiscal rule in place for the past ten years, the average fiscal space for those years is around 22% of GDP higher. The coefficient is proportional to the number of years in which a fiscal rule has been in place. . . . [I]f governments have fiscal rules in place, the results suggest that governments can no longer fully use their fiscal space and (on average)

> are even forced to reduce their current expenditures. . . . [E]xpenditure rules . . . are correlated with a lower coefficient for fiscal space on procyclicality. This is in line with our findings . . . that expenditure rules might restrict discretionary expenditures.

Conclusion

When even the IMF and OECD agree that spending caps are effective, that's a remarkable sign that all other options do *not* work. But there really wasn't any other possible conclusion. Requirements for balanced budgets in 49 out of 50 states haven't prevented wasteful spending and more debt. Maastricht anti-deficit and anti-debt rules in the European Union haven't blocked bloated welfare states and fiscal crisis.

Spending caps are simple and easy to understand, and they directly address the real problem of excessive spending. And in the few places they've been tried, the evidence shows that dealing with the underlying disease of too much government automatically fixes the symptom of red ink. The United States could avert a very bad long-run fiscal crisis by copying the wise policies of Switzerland and Hong Kong.

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—Prepared by Daniel J. Mitchell

25. Fiscal Federalism

Congress should

- begin terminating the more than 1,100 federal aid programs, which give state and local governments almost $700 billion annually in subsidies for education, highways, housing, transit, and other activities; and
- convert Medicaid from an open-ended matching grant to a block grant to reduce federal costs and encourage efficiency at the state level.

The federal government has developed a complex financial relationship with state and local governments through the grants-in-aid system. The system has grown for more than a century as the federal government has increasingly intervened in state and local activities. Today there are more than 1,100 different federal aid programs for the states. Each program has its own rules and regulations, and the overall system is a complicated mess.

It was not supposed to be this way. Under the U.S. Constitution, the federal government was assigned specific, limited powers, and most government functions were left to the states. To ensure that people understood the limits on federal power, the nation's Founders added the Constitution's Tenth Amendment: "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."

The Tenth Amendment embodies federalism, the idea that federal and state governments have separate areas of activity and that federal responsibilities are "few and defined," as James Madison noted. Historically, federalism acted as a safeguard of American freedoms. President Ronald Reagan noted in Executive Order 12612, "Federalism is rooted in the knowledge that our political liberties are best assured by limiting the size and scope of the national government."

Unfortunately, policymakers and the courts have mainly discarded federalism in recent decades. Congress has undertaken many activities that had been reserved to the states and the people. Grants-in-aid are a key mechanism that the federal government has used to extend its control. Grant programs are subsidies that come bundled with federal regulations to micromanage state and local activities.

The federal government will spend almost $700 billion on aid to the states in 2017, making it the largest item in the federal budget after Social Security. Some of the major federal aid programs are for education, health care, housing, and transportation.

There are few, if any, real advantages of federalizing state and local activities through aid programs, but many disadvantages. The aid system encourages excessive spending and bureaucratic waste, reduces political accountability, and stifles policy diversity and innovation. With the ongoing flood of red ink in Washington, now would be a great time to cut the overgrown grants-in-aid system.

Brief History of Federal Aid

Prior to the Civil War, proposals to subsidize state and local activities were occasionally introduced in Congress, but they were routinely voted down or vetoed by presidents. The resistance to federal funding of state activities started to weaken toward the end of the 19th century. The Morrill Act of 1862 provided grants of federal land to the states for the establishment of colleges that focused on agriculture, mechanical studies, and the military. This was the first grant program with "strings attached." It included detailed rules for recipients to follow and required them to submit regular reports to the federal government.

Federal aid activity increased substantially in the early 20th century. When the income tax was introduced in 1913, it provided the means for policymakers to finance a range of new federal aid programs. There was resistance to the expansion of federal aid, but it was politically difficult for states to opt out of new programs. If they opted out, their residents would still have to pay federal taxes to support federal aid spending in other states.

Various sleights of hand were used to get around constitutional barriers to federal intervention in state and local affairs. For example, a 1916 law that created a broad-based federal program for road subsidies was premised on the constitutional power to fund "post roads," or roads used for mail

delivery. Federal aid to schools and airports was originally justified on military grounds.

The number of grant-in-aid programs increased steadily from the 1920s to the 1950s and then exploded during the 1960s. Under President Lyndon Johnson, aid programs were added for housing, urban renewal, education, health care, and many other activities. The number of aid programs quadrupled from 132 in 1960 to 530 by 1970.

Policymakers were optimistic that federal experts and federal money could solve complex local problems such as urban decay. But as the failures of aid began to mount, the optimism faded. President Richard Nixon argued that federal aid was a "terrible tangle" of overlap and inefficiency. In his 1971 State of the Union address, he lambasted "the idea that a bureaucratic elite in Washington knows best what is best for people everywhere," and said that he wanted to "reverse the flow of power and resources from the states and communities to Washington." For his part, President Jimmy Carter proposed a "concentrated attack on red tape and confusion in the federal grant-in-aid system." Unfortunately, Nixon and Carter made little progress on reforms.

President Ronald Reagan had more success at sorting out the "confused mess" of federal aid, as he called it. In a 1981 budget law, dozens of grant programs were eliminated and many others were consolidated. Unfortunately, Reagan's progress at trimming federal aid was reversed after he left office, and there have been few efforts to cut the aid system since then. The number of aid programs has more than tripled from 335 in 1985 to more than 1,100 today.

Eight Reasons to Cut Aid

The theory behind grants-in-aid is that the federal government can create subsidy programs in the national interest to efficiently solve local problems. The belief is that policymakers can dispassionately allocate large sums of money across hundreds of activities according to a rational plan designed in Washington.

The federal aid system does not work that way in practice. Federal politicians do not have the knowledge to design programs that maximize net benefits on a national basis, and they put most of their efforts into grabbing subsidies for their own states. At the state level, federal aid stimulates overspending and creates a web of top-down rules that destroy innovation. Officials at all levels of the aid system focus mainly on spending and regulations, not on delivering quality services.

The following are eight reasons that the federal aid system does not make economic or practical sense and ought to be cut and eventually eliminated.

1. There is no magical source of federal funds. Aid supporters bemoan a "lack of resources" at the state level and believe that Uncle Sam has endlessly deep pockets to help out. But every dollar of federal aid sent to the states is ultimately taken from federal taxpayers who live in the 50 states. It is true that the federal government has a greater ability to run deficits than state governments, but that is an argument against the aid system, not in favor of it. By moving the funding of state activities to the federal level, the aid system has tilted American government toward unsustainable deficit financing.

2. Aid spurs wasteful spending. The basic incentive structure of aid programs encourages overspending by federal and state policymakers. Policymakers at both levels can claim credit for spending on a program, while relying on the other level of government to collect part of the tax bill.

Also, aid programs often include features such as matching that prompt the states to increase spending. A typical match is 50 percent, which means that for every $2 million a state expands a program, the federal government chips in $1 million. Matching reduces the "price" of states' added spending, thus prompting them to expand programs. The largest aid program, Medicaid, is a matching program.

One way to reduce the incentive to spend is to convert open-ended matching grants to block grants. Block grants provide a fixed sum to each state and allow greater program flexibility. An example of such a reform was the 1996 welfare overhaul, which turned Aid to Families with Dependent Children (an open-ended matching grant) into Temporary Assistance for Needy Families (a lump-sum block grant). Similar reforms should be pursued for Medicaid and other programs. Converting programs to block grants would reduce incentives for states to overspend, and it would make it easier for Congress to cut federal spending down the road.

3. Aid allocation does not match need. Supporters of federal grants assume that funding can be optimally distributed to those activities and states with the greatest needs. But even if such redistribution was a good idea, the aid system has never worked that way in practice. A July 1940 article in *Congressional Quarterly* lamented, "The grants-in-aid system in

the United States has developed in a haphazard fashion. Particular services have been singled out for subsidy at the behest of pressure groups, and little attention has been given to national and state interests as a whole." And a June 1981 report by the Advisory Commission on Intergovernmental Relations concluded that "federal grant-in-aid programs have never reflected any consistent or coherent interpretation of national needs." The situation remains the same today. With highway aid, for example, some states with greater needs due to growing populations—such as Texas—consistently get the short end of the stick on funding.

4. Aid raises costs and reduces diversity. Federal grants reduce state diversity and innovation because they come with one-size-fits-all mandates. A good example was the 55-mile-per-hour national speed limit, which was enforced between 1974 and 1995 by federal threats of withdrawing highway grant money. It never made sense that the same speed limit should be imposed in uncongested rural states and congested urban areas; Congress finally listened to motorists and repealed the mandate.

The Davis-Bacon labor rules are another example of harmful regulations tied to federal aid. State public works projects that receive federal aid must pay workers "prevailing wages." Since that generally means higher union-level wages, Davis-Bacon rules increase construction costs on government investments, such as highway projects.

5. Aid regulations breed bureaucracy. Federal aid is not a costless injection of funding to the states. Federal taxpayers pay the direct costs of the grants, but taxpayers at all levels of government are burdened by the costly bureaucracy needed to support the system. The aid system engulfs government workers with unproductive activities such as proposal writing, program reporting, regulatory compliance, auditing, and litigation.

Many of the 16 million people employed by state and local governments deal with the complex federal regulations attached to federal aid. There are specific sets of rules—sometimes hundreds of pages in length—for each of the more than 1,100 aid programs. There are also "crosscutting requirements," which are provisions that apply across federal aid programs, such as labor market rules.

6. Aid creates policymaker overload. One consequence of the large aid system is that the time spent by federal politicians on state and local issues takes away from their focus on truly national issues. Past

investigations have revealed, for example, that most members of the House and Senate intelligence committees do not bother, or do not have the time, to read crucial intelligence reports. But members and their staff put great amounts of time and effort into steering spending toward their home states on local activities that should not have been federalized to begin with.

The federal involvement in hundreds of nonfederal policy areas overloads Washington's policy agenda. President Calvin Coolidge was right when he argued in 1925 that aid to the states should be cut because it was "encumbering the national government beyond its wisdom to comprehend, or its ability to administer" its proper roles.

7. Aid makes government responsibilities unclear. The three layers of government in the United States no longer resemble a tidy layer cake. Instead, they resemble a jumbled marble cake with responsibilities fragmented across multiple layers. Federal aid has made it difficult for citizens to understand which level of government is responsible for particular policies and activities. All three levels of government play big roles in such areas as transportation and education, which makes accountability difficult. After failures, politicians blame other levels of government, as was evident after Hurricane Katrina in 2005. When every level of government is responsible for a policy area, no level of government is responsible.

8. Common problems are not necessarily national priorities. Policymakers often argue that state, local, and private activities require federal intervention because they are "national priorities." But as President Reagan noted in Executive Order 12612, "It is important to recognize the distinction between problems of national scope (which may justify federal action) and problems that are merely common to the states (which will not justify federal action because individual states, acting individually or together, can effectively deal with them)."

Consider education. It is a high priority of local governments across the country and many millions of people, and thus there is no need for federal involvement. Federal involvement just creates bureaucracy and a national tug of war over funding. By contrast, when spending decisions are made at the local level, cost and benefit tradeoffs better reflect the preferences of people within each jurisdiction.

Conclusions

The federal aid system is a roundabout way of funding state and local activities. By federalizing those activities, we are asking Congress to do

the impossible—to efficiently plan for the competing needs of a vast and diverse nation of 320 million people. The system thrives not because it creates good governance, but because it maximizes benefits to politicians. The system allows politicians at each level of government to take credit for spending, while blaming other levels of government for program failures and high tax burdens. The federal aid system is a triumph of expenditure without responsibility. It should be cut and eventually terminated altogether.

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—Prepared by Chris Edwards

26. Campaign Finance: Fixing an Overregulated Marketplace of Ideas

Congress should

- repeal the prohibition on soft money fundraising in the Bipartisan Campaign Reform Act of 2002;
- repeal limits on spending coordinated between a political party and its candidates;
- repeal contribution limits in federal campaign finance law;
- carefully scrutinize the views of Supreme Court nominees about free speech and campaign finance;
- reject the future iterations of the DISCLOSE Act as well as other attempts to curtail free speech through onerous and unnecessary disclosure rules; and
- ensure that nonqualified agencies such as the SEC and the IRS are restrained from interfering with election-related spending.

The 107th Congress passed the most sweeping new restrictions on campaign finance in a generation, the Bipartisan Campaign Reform Act of 2002 (BCRA, also known as the McCain-Feingold Act). During the 108th Congress, the Supreme Court approved almost all of BCRA. Since then, the Court has become much more protective of free speech. In *Citizens United v. Federal Election Commission* (2010), the Court held that Congress could not prohibit corporations and unions from spending independently on speech supporting or opposing candidates. A lower court later followed *Citizens United* and found that individuals who form groups limited to independent spending could not be bound by contribution limits. Such "super" political action committees (PACs) have been impor-

tant in recent elections. Although the courts have trimmed BCRA back, federal campaign finance law still limits free speech in important ways. Congress should supplement judicial efforts by eliminating restrictions on party funding and by removing contribution limits. Congress should also remain vigilant about challenges to these achievements during the 115th Congress.

Liberty and Corruption

The First Amendment to the Constitution prohibits governments from abridging the freedom of speech, and political speech receives the highest protection. In the seminal case of *Buckley v. Valeo* (1976), the Supreme Court recognized that restrictions on political spending abridge political speech:

> A restriction on the amount of money a person or group can spend on political communication during a campaign necessarily reduces the quantity of expression by restricting the number of issues discussed, the depth of their exploration, and the size of the audience reached. This is because virtually every means of communicating ideas in today's mass society requires the expenditure of money.

Note that the Court did not say, "money equals speech." But just as a restriction on money that can be spent on an abortion is a restriction on abortion, restrictions on the raising and spending of money used to disseminate political messages are ultimately restrictions on political speech.

Some believe there is "too much money" in elections, implying the nation would be better off with limits on giving. But people spend money to try to persuade voters to go to the polls, to cast a ballot for a particular candidate, or to support a particular issue. If we believe that the nation is better off if voters cast a more informed vote, we ought to encourage, not restrict, campaign spending. John J. Coleman of the University of Minnesota found that campaign spending increases public knowledge of the candidates across all groups in the population. Implicit or explicit spending limits reduce public knowledge during campaigns. When more money is spent on campaigns, voters and society benefit by improving public decisionmaking.

But Congress does limit spending on federal campaigns. In *Buckley v. Valeo*, the Supreme Court upheld limits on contributions to candidates, concluding that limits on contributions served two important interests.

The limits prevent "corruption and the appearance of corruption spawned by the real or imagined coercive influence of large financial contributions on candidates' positions and on their actions if elected to office." The Court defined corruption as exchange of large contributions for "a political *quid pro quo* from current and potential office holders." The Latin phrase *quid pro quo* means "something for something." This exchange, the Court continued, undermines "the integrity of our system of representative democracy." Representatives should respond to the wishes of a majority on most matters; quid pro quo arrangements imply that representatives respond to money.

It is difficult to determine when contributions are offered in exchange for favors. Scholars of campaign finance have found that individuals and groups generally give to candidates and causes that already support their views. That makes sense: Is it easier to support a candidate who already shares your views or to spend enough money to induce a candidate to change his or her mind? Perhaps quid pro quo corruption exists when money changes a politician's mind. Public officials might alter their vote about an issue in exchange for a contribution. But scholarly studies over many years find little evidence that contributions significantly affect policy-making once other factors (partisanship, ideology, and constituency preferences) are taken into account. In the name of countering the insignificant effect of contributions on politicians' behavior, Congress has taken a sledgehammer to political speech, making election-related speech more heavily regulated than pornography.

Critics of political spending often say that politicians trade access for contributions. Sometimes they mean that officeholders meet with contributors to discuss their concerns and proposals. Let's imagine, however, that a contribution goes toward advancing a candidate's campaign rather than toward getting him to support policies he would not otherwise support. If the Flat Earth Society gives a candidate $50,000 (which is currently illegal), and the candidate agrees to meet with them to hear their concerns, is that problematic or is it just normal politics? Isn't meeting with concerned citizens, even if they're the Flat Earth Society, an essential part of democracy? "Access" in itself does not seem to be the problem. Rather, access becomes a problem if it is part of a quid pro quo relationship involving money rather than politics.

Independent spending on speech for or against candidates exceeds money spent by candidates themselves. Some argue that public officials know about and reward such support, creating a kind of quid pro quo.

Evidence on this point is hard to come by. Those who spend large sums devote their efforts to one party or the other; such spending seems ideological or partisan, an expression of political commitment, rather than an attempt to buy policy favors.

The *Buckley* Court decision also said contribution limits were justified by "the appearance of corruption stemming from public awareness of the opportunities for abuse inherent in a regime of large individual financial contributions." The appearance of wrongdoing, the Court suggested, would erode public confidence in representative government. By limiting contributions, Congress would support public confidence in government. Now, many people from both parties believe that Congress is "corrupt," but what they mean by "corruption" is usually difficult to discern. Sometimes "corruption" seems to be synonymous with "not enacting preferred policies"; thus, the lack of, say, single-payer health care is seen as evidence of corruption. In years past, however, when modern campaign finance restrictions were not in place, people tended to have much more trust in government. Our growing distrust of government seems to be a product of something other than political spending, such as the significant partisan divide currently in Washington.

Here is a summary of the relationship of contribution limits and trust in government. The United States had no limits on individual contributions during the era of highest trust in government. Trust in government and effective limits on donations have varied since that high point. In the era of no limits, trust rose until 1963 and then fell until 1974, when contribution limits were enacted. From 1974 until 1980, trust continued to fall. In 1980, the limits on giving to political parties were loosened; trust began to rise until 1986 when it plateaued and began to fall about 1989. Trust then started rising again after the middle of 1994 until the end of 2001. The McCain-Feingold law banned unlimited contributions to the parties in 2002; trust in government fell until about January 2010. *Citizens United* effectively removed limits on independent spending in early 2010; since then, trust has varied in a narrow range, but the trend is flat. No doubt many factors affected public trust over the years, but both limited and unlimited campaign contributions seem consistent with rising and falling confidence in government. In the states, scholars have found campaign finance regulations "are simply not important determinants of trust and confidence in government."

Contribution limits have another flaw. Individuals can donate only $2,700 to a candidate in an election; if they wish to give more, they must

find a suitable super PAC. Looked at another way, contribution limits push some funding for political speech away from established channels and toward relatively new institutions (like super PACs) that exist because contribution limits curtail direct donations to candidates and because the First Amendment protects direct spending on speech. Many, but not all, donors would probably support speech through established institutions if they could, but the limits make that impossible.

Should federal law favor "outsiders" at a cost to "insiders"? Perhaps. Insiders might care too much about organized groups in the capital; outsiders can force the concerns of a broader public onto the public agenda. But, compared with parties, outsiders lack experience organizing and representing mass opinion. Resources may be wasted and civic-minded folks frustrated. Outsiders might also be more extreme in their commitments, a virtue or a vice depending on your point of view. Other arguments for and against insiders and outsiders come to mind. Which side should win the argument is not clear.

Let's look at the issue in a different way. The voters are supposed to choose the government. If government favors one group over another, it helps choose itself. Election laws should instead be neutral toward those engaged in politics. Contribution limits are not neutral; they favor outside spending over established channels. Citizens, not public officials, should choose between insiders and outsiders. Removing contribution limits would mean that political spenders would not have a *legal reason* to favor outsiders over insiders. A given spender may have a personal reason for preferring one mode of spending to another, but the law should be neutral between the two.

The question of neutrality goes beyond individual donors. BCRA prohibited "soft money" contributions to the political parties in 2002. The courts have struck down much of BCRA, but this prohibition remains. In other words, individuals or organizations may give as much as they wish to super PACs but not to the political parties. This unusual preference for "outsiders" over "insiders" would end if Congress removed the soft money ban.

Last, but far from least, is the problem of electoral competition. Campaign finance regulation brings every member of Congress face-to-face with the problem of self-dealing—not only the self-dealing that the regulations are supposed to prevent but, more immediately, the self-dealing that is inherent in writing regulations not simply for oneself but for those who would challenge one's power to write such regulations in the first place.

Put simply: elected officials are writing the rules by which they get chosen for office, and it may not be a coincidence that many of those rules disproportionately harm challengers over incumbents. Unseating incumbents is very difficult, and campaign finance restrictions only make it harder. Even in the "revolution" of 1994, which changed control of the House of Representatives, 90 percent of incumbents were reelected. In the Tea Party wave of 2010, 85 percent of House members and 84 percent of senators were reelected. The 2010 Tea Party elections were the first time the House reelection rate dipped below 90 percent since 1992.

Campaign finance restrictions may not fully explain the lack of competition for incumbents in American politics. But those restrictions encumber entry into the electoral market and thus discourage credible challenges to incumbents. A challenger needs large sums to campaign for public office, especially at the federal level. He needs big money to overcome the manifest advantages of incumbency—name recognition, the power of office, the franking privilege, a knowledgeable staff, campaign experience, and, perhaps most important, easy access to the media. Current law limits the supply of campaign dollars: an individual can give no more than $2,700 to a candidate, and a political party or a political action committee can give no more than $5,000. In a free and open political system, challengers could find a few "deep pockets" to get them started, then build support from there, unrestrained by any restrictions save for the traditional prohibitions on vote selling and vote buying.

Disclosure

Although disclosure of campaign spending was upheld in *Citizens United*, Congress should be wary of attempts to use onerous disclosure regimes as a backdoor to regulating speech. The Supreme Court has affirmed the right to anonymous speech (*McIntyre v. Ohio Elections Commission*) and anonymous association (*NAACP v. Alabama*), yet the precise contours of how far Congress or state legislatures can go in mandating disclosure are still unclear. Many lawmakers are trying to use that lack of clarity to hinder campaign spending.

In recent years, the Democracy Is Strengthened by Casting Light On Spending in Elections Act (DISCLOSE Act) has been the most significant attempt to impose demanding disclosure requirements. But those requirements have few benefits, and they greatly encumber free speech. In its various forms, the DISCLOSE Act seeks to mandate disclosure of independent corporate spending to voters, citizens, and shareholders. Although

the vast majority of election spending is already disclosed, lawmakers and pundits still rail against so-called "dark money"—a term that usually describes spending by 501(c)(4)s and 501(c)(6)s.

Given the prevalence of the term "dark money" in political rhetoric, one could be excused for thinking that most election-related spending is "dark." Yet according to the Center for Responsive Politics, in 2014, "dark money" accounted for $175 million of the total $3.7 billion spent, or 4.7 percent. While the absolute amount of both disclosed and undisclosed independent spending has increased since 2000, "dark money" still represents a small part of election spending. The general increase in independent spending is likely due to the increased partisanship around politics and, in particular, around which party controls Congress and the presidency.

Disclosure advocates insist that voters "need to know" who is spending money in elections. This proposition is dubious in most circumstances. It's hard to imagine a situation in which a voter would need to know who donated $400 or even $4,000 to cast an informed vote. For voters committed to a party or an ideology, such knowledge is irrelevant; for marginal voters, studies have found that such information has little effect.

But disclosure can have a large effect on encumbering political speech, particularly in an increasingly partisan and volatile political climate. In 2014, for example, former Mozilla chief executive and founder Brendan Eich resigned after it was revealed that he contributed $1,000 to an anti-gay-marriage group. It is hard enough to support an unpopular cause, say gay rights in 1980 or opposition to gay rights in 2016, without adding the burden of having the names and addresses of supporters publicly disclosed and available on a website. Politics can create enemies of friends, and people should not be forced by the government to disclose to their neighbors what causes they support.

Until the Supreme Court weighs in on the proper balance between voter information and donor privacy, lawmakers at all levels should resist new disclosure laws that provide little benefit to the electorate and do much harm to free speech. Lawmakers should also be wary that disclosure laws are often proposed for the implicit, and sometimes explicit, purpose of dissuading political engagement through public shaming and other actions. Valid disclosure laws should be narrowly tailored to achieve a compelling government interest, and they should not be justified by mere hand-waving reference to "voter information."

Finally, in recent years, some have called on the Securities and Exchange Commission (SEC) and the Internal Revenue Service (IRS) to scrutinize

election-related speech. When the IRS imposed onerous compliance requirements on conservative political groups, some evidence suggested that the agency had been pressured to scrutinize political speech. In 2013, the IRS proposed onerous new rules for 501(c)(4)s, which broadly defined "candidate-related political activity" in a way that could have threatened the continued existence of 501(c)(4)s. The IRS is not qualified to regulate political speech, and Congress should resist any future attempts to increase the IRS's regulation of political groups. Similarly, many have proposed that the SEC should ensure that the political activities of publicly traded companies are disclosed to shareholders. Again, regulating political groups and political speech, if it is to be done at all, is the province of the Federal Election Commission, not the SEC. Congress should continue to block any attempt to involve the SEC in campaign finance.

Judicial Nominations

Campaign finance has emerged as one of the most contentious issues of our time, and there is little indication that this will change. Both sides have coalesced around fundamentally irreconcilable visions of the First Amendment. Judicial nominees at the federal level should be heavily scrutinized on which version of the First Amendment they endorse.

On one side, campaign finance reform advocates view the First Amendment as empowering agencies and courts to make the "marketplace of ideas" more fair. On the other side are those who rightly resist any interpretation of the First Amendment that empowers rather than limits the government.

For 200 years, until *Austin v. Michigan Chamber of Commerce*, the Supreme Court viewed the First Amendment as limiting rather than granting government power. *Citizens United* overruled *Austin* and thus reestablished, in the words of Justice Antonin Scalia, "the central truth of the First Amendment: that government cannot be trusted to assure, through censorship, the `fairness' of political debate."

Today, many jurists and academics deny that central truth; they want the government to play an active role in regulating political debate for fairness. Yet there are no meaningful, objective standards by which an agency or a court could determine whether a political debate is fair, and any attempt to do so is sure to be imbued with bias. This is precisely why that interpretation of the First Amendment is not just wrong, it is dangerous. The "fairness" theory is not a modification of existing First Amendment doctrine, it is a fundamental shift away from over two centuries of

liberalism, in the classical sense of the word. Congress should determine whether judicial nominees support that long liberal tradition of free and open politics and resist confirming those who do not.

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—Prepared by John Samples and Trevor Burrus

27. Reclaiming the War Power

Congress should

- repeal the 2001 Authorization for the Use of Military Force and the 2002 Iraq War authorization;
- debate a narrowly tailored, time-limited authorization for military action against ISIS; and
- amend the War Powers Resolution to clarify its application to remote weaponry and include an automatic funds cutoff for unauthorized wars.

"The Constitution supposes, what the History of all Governments demonstrates," James Madison wrote to Thomas Jefferson in 1798, "that the Executive is the branch of power most interested in war, and most prone to it. It has accordingly with studied care, vested the question of war in the Legislature." As James Wilson had earlier explained to the delegates at the Pennsylvania ratifying convention, "This system will not hurry us into war; it is calculated to guard against it."

In the post-9/11 era, the United States has drifted toward a radically different regime. The 2001 Authorization for Use of Military Force (AUMF) was enacted to target the perpetrators of the September 11th attacks. Yet, two successive presidents have treated it as a wholesale, potentially permanent delegation of congressional war powers. Fifteen years later, that authorization has been transformed into an open-ended writ for globe-spanning presidential war. By the end of his tenure, President Barack Obama, who campaigned on "seek[ing] a new dawn of peace," had bombed seven countries, launched 10 times as many drone attacks as his predecessor, and, as the *New York Times* noted in July 2016, was poised to become "the first two-term president to have presided over a nation at war for every day of his presidency."

Nor, it seems, is there any end in sight. A top Pentagon official told the Senate in 2013 that the original war against al Qaeda will last "beyond the second term of this president . . . at least 10 to 20 years." Our latest war in the Middle East, against the so-called Islamic State (ISIS), will also take some "10 to 20 years," the Army chief of staff affirmed in 2015. "It's going to be a generational struggle," echoed the vice chairman of the Joint Chiefs. *This* system will not hurry us into peace.

The 2001 AUMF: An Enabling Act for Limitless War

The 2001 AUMF, passed by the 107th Congress three days after the 9/11 attacks, targeted those who "planned, authorized, [or] committed" the attacks (al Qaeda) and those who "aided" or "harbored" them (principally, the Taliban). Judging by what they said at the time, the legislators who passed the resolution didn't imagine that they had sanctioned an open-ended, multigenerational war. This authorization was nothing like the Gulf of Tonkin Resolution that underwrote the Vietnam War, then-Sen. Joe Biden insisted after the vote: "We do not say pell-mell, `Go do anything, any time, any place.'"

The post-9/11 AUMF has now been in effect for over twice as long as the Gulf of Tonkin Resolution, and our two post-9/11 presidents have stretched it into the boundless grant of power Biden disclaimed. Over the last decade and a half, the 2001 AUMF has served to underwrite a set of far-flung conflicts against a shifting succession of jihadist groups with ever more tenuous connections to the resolution's language and original purpose.

By the spring of 2013, senior Obama administration officials were telling the *Washington Post* they were "increasingly concerned that the law is being stretched to its legal breaking point." That was before the administration stretched the AUMF still further, to provide legal cover for the war against ISIS that President Obama launched in August 2014.

At first, the administration seemed reluctant to outline just how the post-9/11 authorization could be stretched to cover a new war against a new enemy, nearly a decade and a half after its passage. The Obama team's earliest attempts at legal justification came in the form of unsigned "talking points" and statements by anonymous administration officials. But as the mission expanded, the president's spokespeople grew bolder. In October 2015, as the administration deployed "boots on the ground" to fight ISIS in Syria, White House press secretary Josh Earnest insisted that "Congress

in 2001 did give the executive branch the authority to take this action. There's no debating that."

How, exactly, does the language of the 2001 AUMF cover the Islamic State, a group that neither perpetrated the 9/11 attacks, "aided" them, nor "harbored" those who did? The Obama administration argued that ISIS basically is al Qaeda—or *an* al Qaeda—based on its predecessor organization's past connections to the group targeted by the 2001 AUMF and ISIS's current claims that it is "the rightful successor to bin Laden's legacy." That bin Laden's actual, designated successor, Ayman al-Zawahri, has repudiated and excommunicated ISIS presents something of a problem for that theory, as does the fact that the two groups are engaged in open warfare against each other. Indeed, headlines like "ISIS Beheads Leader of al Qaeda Offshoot Nusra Front" and "Petraeus: Use al Qaeda Fighters to Beat ISIS" might give one cause to wonder—or even *debate*—whether ISIS is the same enemy Congress authorized President George W. Bush to wage war against, back before Steve Jobs unveiled the first iPod.

"Take a Vote" on an ISIS AUMF

Thus far, there's been all too little debate in Congress over the legal basis for our latest war. In his 2016 State of the Union address, President Obama practically taunted Congress over its lethargy and irrelevance: "authorize the use of military force against ISIL. Take a vote," he demanded—while making clear in the very next sentence that "with or without congressional action," the war would continue.

During the 114th Congress, several members offered proposals for reining in the expansive war powers the president claims. Bills drafted by Sen. Ben Cardin (D-MD) and Rep. Barbara Lee (D-CA) aimed at the source of those claims directly, sunsetting and repealing the 2001 AUMF. But a stand-alone repeal is highly unlikely. When Lee's proposal, in the form of an amendment to the 2017 National Defense Authorization Act, got to the floor, it failed by a nearly 150-vote margin. A package deal retroactively authorizing the war against ISIS may be a necessary precondition for AUMF reform. That's the theory behind proposals introduced by Rep. Adam Schiff (D-CA) and senators Tim Kaine (D-VA) and Jeff Flake (R-AZ).

Given the history of past AUMFs—which suggests that presidents will stretch the authority they are granted as far as language will allow, and possibly further—Congress should reject any new authorization unless it

is carefully crafted to reduce the potential for presidential abuse. An ISIS AUMF should, at a minimum:

- **Repeal prior AUMFs.** Unless a new AUMF clearly supersedes past authorizations, the next president will remain free to flout its restrictions by claiming that his or her actions are being carried out under prior authorizations for different wars. Thus, any new AUMF should repeal the 2001 authorization and the 2002 Iraq War AUMF, which the Obama administration has invoked as an alternative legal basis for the fight against ISIS.
- **Impose time limits.** Any new AUMF should also include an expiration date, preventing future presidents from claiming authorization-in-perpetuity. The Schiff bill and the Kaine/Flake AUMF both impose a three-year sunset, which, as with the PATRIOT Act, could force Congress to regularly deliberate on whether the authority granted continues to be necessary.
- **Impose geographic limitations.** A new AUMF should also guard against "mission creep" to new theaters of war. Sending U.S. ground troops to Libya to combat ISIS elements was not on the president's "horizon at the moment," Secretary of State John Kerry said in February 2016, but "the president will never eliminate every option forever," if things change. By May of that year, the administration had begun deploying special operations forces for a possible ground campaign against ISIS associates in Libya. Congress should restrict the president's options for him, requiring him to seek authorization for any new expedition beyond Iraq and Syria.
- **Restrict ground combat operations.** Tactical mission creep has already occurred with U.S. special forces' growing combat role in Iraq and Syria. Ideally, a new AUMF would address that problem directly, barring the use of ground forces outside of special, specifically enumerated circumstances. The Schiff proposal drafted in late 2015 offers a compromise that would require the president to notify Congress of the use of ground forces and would fast-track member action to restrict their use.
- **Mandate transparency.** Most important, any new authorization must remove the veil of secrecy that has allowed 15 years of mission creep under the 2001 AUMF. As law professors Jack Goldsmith, Ryan Goodman, and Steve Vladeck have argued, "Any new AUMF should require the president to identify the groups against which force is used, along with related details, regularly in a report to Congress."

The Challenge of War Powers Reform

Revoking the "blank check" of the 2001 AUMF is necessary, but not by itself sufficient, to restoring legal restraints on presidential war making. After all, President Obama's expansion of the 2001 AUMF wasn't his only dangerous innovation in the field of constitutional war powers. He launched his first "war of choice," the 2011 campaign against the Muammar el-Qaddafi regime, without reference to any congressional authorization whatsoever. Instead, the president advanced the extraordinary argument that seven months of regime-change bombing in Libya was not a "war" for constitutional purposes, nor did it even rise to the level of "hostilities."

Shortly after ordering airstrikes against the Libyan government, Obama assured Congress that the campaign would last "days, not weeks." But as the weeks dragged on, the administration faced a legal dilemma in the form of the War Powers Resolution (WPR), passed by Congress in 1973 to "fulfill the intent of the framers of the Constitution . . . [and] insure that the collective judgment of both the Congress and the President will apply to the introduction of United States Armed Forces into hostilities." Section 5(b) of the WPR stipulates that the president "shall terminate" U.S. forces' engagement in "hostilities" after 60 days unless Congress specifically authorizes the intervention. But our NATO (North Atlantic Treaty Organization) allies, it turned out, were incapable of completing the mission without active participation of U.S. warplanes and drones.

Though the Office of Legal Counsel (OLC), the executive branch's principal legal adviser, had been willing to bless the initial air campaign in a memo arguing it wasn't "a `war' within the meaning of the Declaration of War Clause," OLC's attorneys balked at the notion that daily bombing raids weren't "hostilities" within the meaning of the War Powers Resolution. The OLC, the Pentagon's general counsel, and the president's own attorney general all told him the WPR applied, and active participation by U.S. forces would have to cease when the 60-day clock ran out. So the president went to the State Department's top lawyer, who came up with the legal cover he wanted.

How threadbare that cover was can be seen in the report the president submitted to Congress on June 15, 2011, nearly 90 days after he'd unilaterally launched the war. "U.S. military operations are distinct from the kind of `hostilities' contemplated by the Resolution's 60 day termination provision," it argued, because they didn't "involve sustained fighting or active exchanges of fire with hostile forces, nor do they involve the presence

of U.S. ground troops, U.S. casualties or a serious threat thereof." As former Bush OLC head Jack Goldsmith put it at the time, "the administration argues that once it starts firing missiles from drones, it is no longer in `hostilities' because U.S. troops suffer no danger of return fire. . . . The implications here, in a world of increasingly remote weapons, are large."

Indeed, under President Obama's interpretation of the WPR, any future president would be legally entitled to rain down destruction from cruise missiles and remote-controlled aircraft at will and at length, so long as the country we're bombing can't easily hit us back. It's an odd, even grotesque, doctrine for a liberal, internationalist president to advance. Put starkly, it says, "Killing a bunch of foreigners isn't *war*. War is what happens when actual *Americans* might get hurt." It's also inconsistent with the plain language and the legislative history of the WPR. Given that outrage over the illegal bombing of Cambodia was part of the backdrop to the resolution's passage, it would have been pretty strange if its drafters thought presidential war making was permissible if done from a great height.

Tendentious and implausible as it is, Obama's redefinition of "hostilities" will surely serve as precedent for future commanders in chief unless Congress forecloses that possibility. Brigham Young University law professor Eric Talbot Jensen argues that "for the WPR to achieve the aim it was originally intended to accomplish, Congress will need to amend the statute to cover emerging technologies that do not require `boots on the ground' to be effective." One way of doing that would be to revise the WPR's statutory triggers to cover "all offensive strikes" and the introduction of "United States Armed Forces *personnel, supplies, or capabilities*" into active or potential hostilities.

Yet even before the Obama administration invented its drone warfare loophole, the WPR was never terribly effective at achieving what it was drafted to accomplish: "fulfill[ing] the intent of the Framers" by restraining presidential war making. In the four decades since its passage, presidents have repeatedly evaded the WPR's constraints to put troops in harm's way and launch wars unilaterally.

Accordingly, war powers reformers in the academy and in Congress have proposed amendments designed to give the resolution teeth. A "Combat Authorization Act," proposed in 1993 by the legal scholar John Hart Ely, would shorten the current 60-day "free pass" to 20 days and command the courts to hear suits by legislators seeking to start the clock. If the court determined that hostilities were imminent, and if Congress did not

authorize the intervention, funds would automatically be cut off after the clock ran out. In 2007, Rep. Walter Jones (R-NC) drafted legislation with similar features, including a congressional standing provision and an automatic funds cutoff for unauthorized wars.

Jones's "Constitutional War Powers Resolution" would be an improvement on the existing framework of the WPR, but hardly a panacea. Even if it could be passed today, and even if the courts, defying most past practice, grew bold enough to adjudicate claims made under it, there would be still another difficulty: as Ely put it, "When we got down to cases and a court remanded the issue to Congress, would Congress actually be able to follow through and face the issue whether the war in question should be permitted to proceed? Admittedly, the matter is not entirely free from doubt."

No framework statute, however thoughtfully crafted, can force Congress to restrain an imperial president if it lacks the political will to do so. Ironically enough, that's a point Barack Obama stressed well before his transition from "peace candidate" to "war president." On October 2, 2007, then-Senator Obama gave a speech at DePaul University in Chicago, timed to mark the fifth anniversary of his 2002 peace rally speech against a "dumb," "rash war" in Iraq. "We all know what Iraq has cost us abroad," he told the 2007 audience, "but these last few years we've seen an unacceptable abuse of power at home. . . . All of this has left us where we are today: more divided, more distrusted, more in debt, and mired in an endless war." Obama continued, "We thought we learned this lesson; after Vietnam, Congress swore it would never again be duped into war, and even wrote a new law—the War Powers Act—to ensure it would not repeat its mistakes. But no law can force a Congress to stand up to the President. . . . No law can give Congress a backbone if it refuses to stand up as the co-equal branch the Constitution made it." That's the challenge facing the 115th Congress today.

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—Prepared by Gene Healy

28. Tort and Class Action Reform

State legislatures should

- enact punitive damages reforms;
- eliminate joint and several liability;
- strengthen judicial review of dubious expert testimony; and
- prohibit government litigants from engaging private attorneys on contingency fee.

Congress should

- restore meaningful sanctions for meritless litigation in federal court;
- constrain courts' long-arm jurisdiction over out-of-state defendants;
- enact a federal choice-of-law rule for multistate litigants in product liability cases; and
- implement further reforms for class actions that cross state lines.

Both state legislatures and Congress should

- strengthen the role of contract and consent-based alternatives to tort litigation, including predispute arbitration, venue selection, disclaimers of liability, and assumption of risk.

Although America has long been considered a litigious nation, its lawsuit sector really took off after the 1960s, following changes in the law aimed at making it easier to sue. As a share of the U.S. economy, tort costs are two-and-a-half times as high as in Western Europe and four times as high as they were after World War II. The direct cost of American tort litigation is upward of $250 billion a year, a figure that does not include important categories such as securities litigation and the multistate tobacco settlement.

In a global marketplace, that means costs are not competitive, business investment is discouraged, there are fewer jobs, and wealth is reduced.

Widely shared discontent over the many ill effects of litigation has made lawsuit reform a popular issue at both state and federal levels. At the state level, advocates have enjoyed considerable success. For example, with California's Medical Injury Compensation Reform Act in the lead, most states have enacted curbs on medical malpractice litigation. The result has been a turnaround in what was once a soaring rate of claims and insurance rate increases associated with that sector.

At the federal level, reform has faced tougher resistance. It is true that Congress has enacted two broad-based reform laws, applying to securities litigation and to multistate class actions, as well as a number of more specialized bills pertaining to specific areas, such as gun liability and small aircraft liability. One reason the federal government has not taken the lead in more areas is that the predominant share of injury litigation goes on in state courts, rather than federal. Under our constitutional structure, though the federal government does play some role in supervising state courts (for example, when they infringe on constitutional rights, or when one state rules on matters affecting the rights of residents of other states), that role does not extend to broadly displacing state authority over conventional, usually smaller, in-state disputes.

State-Level Tort Reform

Because of the strong ongoing interest in state-level reform, lawmakers can choose from a large menu of ideas that have proved themselves in other states. Here are four.

First, states should limit or abolish the availability of punitive damages in civil cases. One good beginning would be to limit them to cases involving actual malice, intentional wrongdoing, or gross—as distinct from ordinary—negligence. Punitive damages share some of the functions of criminal law, and thus call for—yet commonly lack—procedural protections that parallel those afforded criminal defendants. Among those protections is a higher burden of proof than the usual civil standard, which is preponderance of the evidence. Another is double jeopardy protection. Current rules allow punitive damage claims over the same conduct to be made again and again in multiple lawsuits. Another is protection against coerced self-incrimination by way of compulsory discovery. Many modern jurisdictions do not allow civil claims for punitive damages at all.

Second, states should dispense with joint and several liability. That's the "deep pockets" rule that permits plaintiffs to collect all of a damage award from any one of multiple defendants, even if the paying defendant was responsible for only a small fraction of the harm. The better rule is to apportion damages in accord with defendants' degree of culpability.

Third, holdout states should join the predominant trend toward stronger judicial review of expert testimony (so-called Daubert review, after the leading Supreme Court case) to cut down on speculative litigation based on flimsy scientific premises.

Fourth, contingency fee contracts between private lawyers and government entities should be prohibited. Private lawyers acting on behalf of government should bear the same ethical responsibility as in-house government lawyers—as public servants beholden to all citizens, including the defendant, and obliged to seek justice. Imagine a state attorney receiving a contingency fee for each indictment, or a state trooper receiving a bonus for each speeding ticket. Contingency fees are equally corrupting.

Tort Reform That Respects Federalism

The Constitution foresees a number of roles for Congress in supervising civil litigation. The least controversial is Congress's power to prescribe rules for the handling of lawsuits brought in federal courts and those based on the federal government's own laws. One example is sanctions against meritless litigation in federal courts under so-called Rule 11. Congress should enact a measure restoring strong sanctions, which were unwisely cut in 1993 after a decade-long experiment in vigorous sanctions. Sanctions should be based on the monetary cost of responding to meritless claims and motions, as specified in the bill known as the Lawsuit Abuse Reduction Act.

Congress also has considerable power to supervise the doings of state courts—for example, when those courts violate litigants' due process, impair the obligation of contract, or abridge the privileges and immunities of citizens of other states. But its power is not "plenary," or unlimited; it may act only when it can cite constitutional authority. Some proposals for federal-level malpractice reform, for example, are unwisely premised on broad New Deal readings of the power to regulate interstate commerce.

On a practical level, not every national problem requires a federal solution. Most states have capped damages in health care suits, with favorable results for their climate of medical practice, and virtually all have at least considered reforms. In the long run, excessive lawsuit recoveries by in-state plaintiffs against in-state doctors over in-state therapy are likely

to generate in-state political pressure for reform. The substantive rules of tort law are not commerce, and proposals to override them with federal law because they have some indirect effects on interstate commerce have no obvious stopping point. Congress is better off focusing its energy on lawsuits in which a state is tempted to assert its sovereignty beyond its borders through its courts. Federal procedural reforms do have an important role to play in curbing that behavior.

Federal Procedural Tort Reform

A guiding principle in supervising interstate litigation is that federal lawmakers and courts are authorized to act when there is a high risk that states will appropriate wealth from the citizens of other states. One federal reform consistent with that principle is to amend the currently lax and ambiguous rules that control state exercise of so-called long-arm jurisdiction over out-of-state businesses. Congress might, for example, preclude a local court from hearing a case unless the defendant engages directly in business activities within the state. A company's mere awareness that the stream of commerce could sweep its product into a particular state should not suffice to confer jurisdiction. A sensible rule would give firms an exit option—that is, they could withdraw from a state and thus avoid the risk of a runaway jury, even if a product somehow ends up in the state.

A second federal reform compatible with federalist principles is a federal choice-of-law rule to prescribe which law governs in cases where plaintiff and defendant in product liability cases are from different states. It might provide that the applicable law is that of the state where the manufacturer was located, or where the product was first sold to a consumer. Consumers would be on notice of the system and could evaluate the rules, if of a state other than theirs, when deciding whether to buy a particular manufacturer's product. States would be more likely to balance the voting interest of in-state consumers against the in-state benefit of a healthy retail or manufacturing sector. In effect, competition among the states would enlist federalism as part of the solution to bad incentives.

The Class Action Fairness Act and Beyond

Multistate class actions were once a rarely used procedural device designed to litigate an assemblage of largely identical claims. In the last half century, they have morphed into a commonly used device for bundling

cases that are often quite dissimilar but which together may command a higher settlement value and steering them into a favorable court.

The 108th Congress attempted to address the latter problem in the Class Action Fairness Act of 2005 (CAFA) by giving defendants the power to remove some class suits from state to federal courts. Although helpful, CAFA left unresolved many issues that courts have had to address through prolonged litigation. Congress should clarify CAFA's gaps and advance the fairness of the process in ways that go beyond the 2005 law. Following are three suggestions to address gaps and four suggestions to go further.

First, under CAFA, a class action can be removed to federal court so long as at least one-third of the class members reside outside the state where the suit was filed and the amount at stake overall exceeds $5 million. The amount-in-controversy threshold, in particular, occasions needless litigation since plaintiffs' damage theories at the outset of a case may lack specifics. Congress can and should clarify what types of evidence and level of certainty are needed to establish a basis for removal. In general, because most national class actions do seek more than the $5 million threshold, Congress should set a rebuttable presumption in favor of removal for national classes.

Second, the key make-or-break stage in a case is typically the motion for class certification. CAFA did not explicitly provide that one federal court's denial of certification bars attempts to relitigate the question before other federal courts. Congress should spell out that federal courts have power to enjoin multiple bites at the certification apple when one has been adequately argued.

Third, CAFA does not provide a means for removal of cases in which plaintiffs' lawyers and defendants, in effect, collude against the interests of the class. At present, if they have in mind what is known as a "sweetheart settlement"—one in which the lawyers get a big payoff, defendants get a slap on the wrist, and absent class members recover little or nothing—they can file in a friendly state court and simply not file removal. Congress should provide that absent class members, and not just defendants, can file for removal.

Beyond plugging gaps in CAFA, Congress should seize the opportunity to rethink the class device itself in its current form. The present rules create a presumption that individuals out of court, who have not affirmed their connection to the class, favor being represented on nothing more than the say-so of the trial lawyer who steps forward to file the action. Modern class-action lawyers often claim to represent the interests of thou-

sands or even millions of people who have no idea that they are litigants at all.

Lawmakers should take four steps to confine class actions to the kinds of cases in which they can best advance justice:

1. Class action rules should require would-be litigants to affirmatively *opt in* to a class action (for example, by mailing a consent form to the court) before being counted as part of the class.
2. Class action rules should assure defendants of their due process right to assert defenses that may apply to some but not other individual plaintiffs. Presently, classes are certified even when a governing statute or common-law rule requires that key elements of proof—such as reliance, causation, or damages—be shown on an individual basis. That means trial lawyers can use the class device to combine tens of thousands of factually dissimilar claims into one proceeding, making it impossible for defendants to adequately smoke out and identify weak or meritless individual claims. Congress should enact a rule stating that, unless a statute clearly provides otherwise, certification and liability in class actions arising under federal law require proof as to all class members of all the elements of each claim.
3. Lawmakers should act to head off the problem of certification of classes in low-merit cases. Class certification decisions are made very early—before plaintiffs have demonstrated that they have evidence to support their allegations. That allows trial lawyers to game the system by filing cases that are extremely unlikely to succeed at trial, but for which the sheer monetary risk generated by a million-member class generates settlement value: Why take even a 1-in-20 risk of a fluke jury outcome if the stakes are of bet-the-company magnitude? Congress should nip meritless class actions in the bud by providing that classes may be certified only after the class "representative"—the main plaintiff—is able to make a preliminary factual showing that he or she has a reasonable likelihood of success.
4. Congress must clarify when, if at all, class actions may go forward on the basis of statistics. Class actions generally must be proved using evidence "common" to all class members, but some federal statutes allow statistical sampling to prove injuries to a large group. Where this is so, plaintiffs sometimes have gotten away with shoddy statistics purporting to show that all class members suffered the same injury. Congress should provide that, before a class action

can go forward, plaintiffs' statistical evidence must meet the same demanding reliability standards imposed on expert evidence sent to a jury.

Defending Arbitration

Allowing parties to set the terms of their own deals reduces the uncertainty that gives rise to litigation and advances the values of individual choice. Yet too often courts and legislators have been hostile to waivers and disclaimers of liability and to contractual provisions that seek to prescribe methods of handling disputes before they arise (such as agreements to arbitrate or mediate, venue selection clauses, and clauses excluding class action treatment of a claim). Arbitration in particular is under attack from organized trial lawyers who would prefer all-out, open-ended litigation as an alternative. Both state and federal lawmakers should defend consumer arbitration.

Courts and lawmakers have also neglected the vital doctrine of assumption of risk, which gives legal force to the choice consumers make to engage in risky activities, such as recreation. Legislators should act to bolster assumption of risk, where appropriate, by codifying doctrines like the "baseball rule" (spectators at a ball game assume the risk of balls hit into the stands) and suitable doctrines limiting liability for ordinary risks experienced by skiers, hikers, and others in search of recreation.

Conclusion

For the most part, the states have reformed and are continuing to reform their civil justice systems. Under those circumstances, time-honored principles of federalism dictate that each state exercises dominion over its substantive tort law. Still, Congress does have appropriate roles to play, both in setting a good example with federal-court litigation and in restraining states from exercising inappropriate jurisdiction beyond their borders or discriminating against out-of-state businesses.

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—Prepared by Robert A. Levy, Mark Moller, and Walter Olson

29. Redistricting

State lawmakers should

- specify objective criteria for redistricting, such as compactness of districts, contiguity, and congruence with political subdivisions;
- prescribe procedures for redistricting that limit political insiders' discretion in drawing district lines, or entrust the process to those without a vested interest; and
- enact transparency measures, including real-time open-source public access to geographic information data, to allow the public to analyze districting maps under consideration and propose alternative maps.

Elected officials often exercise their power in ways that benefit themselves and their associates even at cost to the public's well-being. A classic example is gerrymandering, the practice of drawing district lines to help ensure the desired result in future elections. The American system tends to leave the power of redistricting in the hands of the same officials whose careers are at stake, and they have routinely misused that power to draw lines with the aim of electing or defeating one or another candidate or party. In a classic gerrymander, the governing party draws many districts in which its own voters hold a comfortable though not overwhelming lead, while packing voters of the opposing party densely into as few districts as possible.

Both parties do it: in states like Texas and North Carolina, Republican-drawn maps have placed Democrats at a disadvantage, while Democrats have done the same to Republicans in states like Illinois and Maryland. When a state legislature is under mixed or split party control, the approach is often one of bipartisan connivance: you protect your incumbents and

we'll protect ours. Third-party and independent voters, as is so common in our system, have no one looking out for their interests at all.

The practice dates far back in history: the name "gerrymander" comes from a dragon-shaped district that Massachusetts Gov. Elbridge Gerry helped devise back in 1812. But it has grown more acute in our own time with the rise of database technologies that can efficiently sort voters by political sympathy down to precincts, city blocks, and even individual buildings. Last year, the *Washington Post* cited Maryland's third congressional district as among the nation's worst offenders. It snakes through four counties and Baltimore city, connected at various points only by water; its silhouette has been compared to that of a praying mantis, a "broken-winged pterodactyl" (a federal judge's phrase), and the blood spatters at a crime scene.

Insulating Incumbents

Handicapping the opposition party is only the start. Creative gerrymandering can insulate incumbents and serve the interests of political insiders in a number of other ways as well:

- Those in charge can punish lawmakers of their own party, as well as opponents, by drawing them unfavorable districts at census time. Incumbents who ignore the leadership's wishes on key votes may find their home address assigned to a tough new district or thrust into a primary fight with a popular colleague. That's one method legislative chieftains use to keep a lid on insurgent forces in their own party.
- Carving up a coherent political community, such as a county or small city, among numerous districts can spare weak incumbents scrutiny of their performance. Residents who do not even know who their representative is, as is common with a scrambled map, are less likely to keep track of how well that representative is serving their interests. With multiple districts, races, and incumbents to follow, press outlets are less likely to do a thorough job of covering any of them.
- Where most seats are seen as belonging to one party or the other, the only meaningful competition tends to come in the primary, and the chief political pressure on incumbents may be to cater to base voters for fear of attracting a primary challenge. Fewer lawmakers have reason to engage with sane voices on the other side.
- When a gerrymandered district sprawls across a state, it's harder for a newcomer to challenge an incumbent. For example, advertising

across multiple media markets is expensive. Making the rounds of local events, such as fairs and parades, winds up wasting a lot of effort on people who vote in other districts. All of which tends to reduce the role of "retail" politics—getting to know constituents face to face or through a strong record in local government—while magnifying the role of fundraising (to afford the high advertising budgets) and cultivating allies among the sorts of interest groups that can turn out disciplined voters statewide.

The Constitutional Background

In our system, states are in charge of apportioning their own legislatures and have the lead role in apportioning congressional districts as well. Article I, Section 4 of the Constitution reads: "The Times, Places and Manner of holding Elections for Senators and Representatives, shall be prescribed in each State by the Legislature thereof; but the Congress may at any time by Law make or alter such Regulations."

The federal government's role has remained limited. The Voting Rights Act of 1965, following the Equal Protection Clause, bans districting done for a racially discriminatory purpose, and drafters of maps must ensure that they are compliant with the act's rules. The federal courts also enforce population equality among districts in a given state, which, under the Supreme Court's ruling in *Baker v. Carr* (1962), extends to state legislative districts as well as congressional districts. (The Court has allowed more leeway, a variance of roughly 10 percent, for state legislature districting.) And both state and federal districts must be reapportioned at least every 10 years to reflect new census results.

Although the Supreme Court has been urged to interpret various constitutional provisions as banning politically motivated gerrymandering, it has thus far declined to do so. Its rationale has been that it has found no principled standard to apply that would not draw it into a multitude of complicated local disputes.

Reforming Redistricting

Fortunately, ideas for reforming gerrymandering are almost as old as the practice itself. They fall into three main categories:

1. rules on who is responsible for drawing district lines;
2. rules directing the shape or extent of districts; and
3. rules on the procedures panels should follow.

Who Should Draw Lines?

Who draws the lines? Too often, the answer is a few majority party insiders huddled in a back room. Who *should* draw the lines? One of the ideas that recurs most frequently is to make the process bipartisan, entitling the second largest party to a negotiating position. New Jersey, for example, entrusts redistricting to a panel selected by political figures with an even party balance and a tie-breaking neutral, with the state's supreme court authorized to step in in case of deadlock.

Most reform proposals floated these days seek to go further in separating the process from incumbent control. In recent years, serious redistricting reform has caught on, especially in Western states, including Washington, Idaho, Alaska, and Colorado. In the first two of these states, the process is entrusted to a commission whose members are mostly selected by elected officials, but who themselves must be citizens not holding office. Voters in Arizona and California, by way of ballot initiatives, have gone the furthest by creating what are closer to fully independent citizen commissions, in whose selection lawmakers have a more limited role.

Although each model has its own details, some features are typical. The selection process is usually meant to avoid empaneling a majority of loyalists from a single party. Elected officials themselves and their families are frequently excluded, and sometimes so are persons who have been candidates recently or are political professionals. Where citizens themselves volunteer, there is commonly some screening process; details vary as to which neutral body does the screening and how, but the intent is to find civic-minded individuals who are qualified for the work. Some plans use random or lottery selection for at least one phase of the screening. That system offers the advantage—as with the process for selecting juries in court cases—of impeding any scheme to "wire" the process to ensure that particular persons get chosen.

In a category of its own—and deserving special mention—is the system used in Iowa. It assigns redistricting to the same nonpartisan civil service staff that provides legislative services such as bill analysis at the capitol. Although Iowa's system is often praised for its fair results, it may owe some of that success to features of the local political scene not replicated everywhere. For example, Iowa has a fairly even party balance and a legislative staff whose nonpartisan bona fides are accepted by lawmakers of both parties.

What Should Districts Look Like?

The most essential task in redistricting reform is to provide clear and objective rules for governing how districts are drawn. The three most widely accepted standards are as follows:

Contiguous. All parts of a district should touch. Although this seems obvious, careful language helps prevent such tricks as corner-to-corner connections or circuitous connections over water.

Compact. Districts should look more like turtles than snakes, more like dustpans than rakes. It is not necessary to trust to intuition: at least two mathematical measures of compactness are widely employed. Colorado writes one of them, the "total perimeter" test, into its constitution: "Each district shall be as compact in area as possible and the aggregate linear distance of all district boundaries shall be as short as possible." The other test—"radius" or "length/width"—is used in a number of states, including Michigan.

Congruent. Where possible, districts should respect the boundaries of smaller political subdivisions, such as counties and towns, and should nest within other districts. No one rule fits every state, because the basic unit of political organization varies from state to state (around much of America it is the county, but in New England it is more typically the town). Some states provide that smaller units cannot be split between districts unless there is no other alternative. Another convenient measure of congruence is the number of county splits in a plan, with lower numbers ordinarily better.

If too many criteria are prescribed, then a dangerous degree of discretion is reintroduced into the process, especially if the commission is given latitude to balance among them. For example, some proposals have suggested that a commission take into account vaguely defined "communities of interest" in assembling districts. But almost anything can be called a community of interest. For example, a coastal low-income suburban industrial enclave could be linked to other coastal areas, other low-income areas, other suburban areas, and so forth. Interested parties will find more ways to manipulate outcomes.

How Should the Process Work?

The rules by which a redistricting commission does its work are important as well. One powerful tool is "blinding," that is, directing the panel not to consider current party registration or past voting records in assembling population blocks. Even more powerful is to direct a panel not to consider the location of residence of any individual, such as incumbents or potential

challengers. Although incumbent-blinding has potential inconveniences—it may wrench a lawmaker out of a district where he or she is well loved, or throw three incumbents into the same district—it has proved practical in states like Iowa and serves as a badge of seriousness in refusing to cater to incumbent interests.

Once a panel agrees on a proposed map, it is typically sent to the legislature for approval. Since giving lawmakers unlimited power to amend the map before approving it is suspiciously akin to letting them draw the map from scratch, some states allow only an up-or-down vote, with any rejection kicked back for a second try. Provisions for judicial review should also be drafted with care: if court review is too weak, participants may feel free to ignore the law; but if it is too easy to sue, courts may wind up mostly drawing the maps themselves. Beleaguered citizen participants would then be left with the unpleasantness of being hauled into court without a sense of accomplishment to make up for it in the end.

Finally, reflecting how rapidly technology has changed in this area, data transparency practices now have great potential to transform redistricting for the better. Public hearings and online comment registers have been a familiar part of the process. Now, provided a state cooperates by making the data available in correct formats, free or inexpensively available software allows almost any computer user to analyze the full data set behind a map, using geographic information systems (GIS) methods. In several states, this has already led to fruitful back-and-forth exchanges in which members of the public offer maps of their own, identify shortcomings in proposed maps, or both. Sometimes these submissions improve the commission's final plan; at other times, they serve as a vehicle for judicial review, as when the Pennsylvania Supreme Court invalidated a map drawn by lawmakers as clearly inferior to a map that had been submitted by Amanda Holt, an Allentown piano teacher.

Conclusion

Redistricting reform makes sense for its own sake and as a safeguard against the entrenchment and insulation of a permanent political class. Voters should choose legislators, not the other way around. It's time for every state to catch up.

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—Prepared by Walter Olson

30. Government Transparency

Policymakers should

- publish data about government deliberations, management, and results in standardized, open formats; and
- fully implement the federal DATA Act (Public Law No. 113-101), expanding it to additional data sets.

Americans widely approve of government transparency, but it is difficult to deliver. President Barack Obama called for transparent government, and his administration began with promises of great strides in transparency. After eight years, however, the federal government achieved only marginal improvements in some areas, with backsliding in others. Passage of the Digital Accountability and Transparency Act (DATA Act) was an important but incomplete step toward the promise of transparency in government spending. What remains to be done at the administration's end is to fully implement the act.

Government transparency is difficult to deliver in part because the practices that produce transparency are not well understood and in part because transparency is not in the interest of some parts of government. Transparency shifts power from government agencies to their overseers in legislatures and the public. Improvements in freedom of information laws are welcome. But modern transparent government will result from the extension of consistent data publication practices to government deliberations, management, and results. Good data publication practices will make those types of information available for processing and wide redistribution on websites and through information services and apps, so people will be fully informed about the activities and expenditures of government.

What Is Transparency?

Everyone agrees that governments at all levels should be transparent, but how to achieve that goal has not been clear. Many people over many years have equated government transparency with the ability to access information about government via "freedom of information" laws. The federal Freedom of Information Act (FOIA) and state counterparts allow the public to demand access to data held by governments. These laws generally establish processes by which citizens may request government-held information, paying minimal costs for accessing it. There are exceptions to disclosure for the sake of protecting individuals' privacy and national security, and many executive branch officers and legislators are exempt.

A significant hindrance to transparency is the low priority that government agencies often give to FOIA requests. The government-wide backlog of FOIA requests at the federal level went from 77,000 in 2009 to nearly 160,000 in 2014, according to a Justice Department report. The numbers have improved somewhat since then.

In 2016, Congress passed the FOIA Improvement Act (Public Law 114-185), seeking to improve FOIA processes at the federal level in various ways. Among them were requirements to disclose records and documents in electronic formats, to publish widely any frequently requested records, to limit fees, to create a presumption of openness, and to permit FOIA requests to be made of any agency from a single website.

Bringing government up to modern standards requires improving on FOIA by making information about government activities available as a matter of course, not based on request. Governments should publish data about their activities as a matter of routine and in digital formats that make it easy for the public, and governments themselves, to access and use.

A 2011 Cato Institute study identified four key data practices that support government transparency. They are authoritative sourcing, availability, machine discoverability, and machine readability. The first, "authoritative sourcing," means producing data as near to its origination as possible—and promptly—so that the public uniformly comes to rely on the best sources of data. The second, "availability," is another set of practices that ensure consistency and confidence in data the government publishes.

The third transparent data practice, "machine discoverability," occurs when information is arranged so that a computer can discover the data

and follow linkages within the data. Machine discoverability is produced when data are presented in a manner consistent with a host of customs about how data are identified and referenced: the naming of documents and files, the protocols for communicating data, and the organization of data within files.

The fourth practice, "machine readability," is the heart of transparency: it allows the many meanings of data to be discovered. Machine-readable data are logically structured so that computers can automatically generate the myriad stories that the data have to tell and put the data to the hundreds of uses the public would make of it in government oversight.

The Subject Matter of Government Transparency Data

Experience with the Obama administration's transparency efforts shows the importance of carefully defining what makes government transparent. The administration can easily say the publication of any data is helpfully transparent. However, only access to the types of information already mentioned—data about government deliberations, management, and results—makes for true government transparency.

In 2009, the Obama White House instructed agencies to produce data for data.gov. The instruction—produce three "high-value data sets" per agency—was broad, and its definition of "high-value" was equally broad. That broad definition permitted agencies to choose data feeds with the greatest likelihood of increasing their discretionary budgets or the least likelihood of shrinking them. The Agriculture Department, for example, published its calorie counts, not its check register.

Digital scholars David Robinson and Harlan Yu identified this shift in policy focus in their paper "The New Ambiguity of `Open Government'":

> Recent public policies have stretched the label "open government" to reach any public sector use of [open] technologies. Thus, "open government data" might refer to data that makes the government as a whole more open (that is, more transparent), but might equally well refer to politically neutral public sector disclosures that are easy to reuse, but that may have nothing to do with public accountability.

The heart of the government transparency effort is getting information about the *functioning* of government: government deliberations, management, and results. Making "deliberations" transparent means publishing the bills in Congress and state legislatures in structured formats with

semantically rich markup or metadata. The rulemaking documents published by agencies should be given similar treatment. Along with the documents, the legislative and regulatory processes followed in rulemaking bodies should be equally transparent: hearings and other meetings, amendments, votes, and other decisions should all be made available in well-structured digital formats.

"Management" essentially refers to the flow of funds. Thus, the published data should cover budgeting, appropriations, allocation of spending authority, obligations, and actual outlays of money—all in formats that tell the story of who was responsible for what spending. "Results" means reporting on what the government activity, including spending, actually produced, hopefully for the betterment of the jurisdiction. Reporting on results is a difficult challenge, but it has been required at the federal level, at least, since Congress passed the Government Performance and Results Act in 1993.

Sound publication of data about deliberations, management, and results will make for a more open, more transparent government. It is important that the subject matter of government data publication remain focused on what makes the government itself transparent.

The DATA Act

One of the most important recent developments in transparency at the federal level was the 2014 passage of the Digital Accountability and Transparency Act of 2014 (DATA Act) (P.L. 113-101). The DATA Act required the federal government to increase the amount of information available on the USASpending.gov website. More important, it required the Treasury Department and Office of Management and Budget in the White House to establish standard data elements and formats to be used government-wide for all federal spending data.

Public access to such data could revolutionize both public oversight and internal management of the federal government. With spending data published in standard formats, a variety of websites, information services, and apps will be able to reprocess and republish the data, making the data available as information to various segments of the public. Data about the activities of agencies may be reported as straightforward statistics, much like the sports statistics found in newspapers, rather than described in "news" articles that contain few facts but many opinions of the authors and their editors. People may be able to draw relationships between bills introduced in Congress, the votes on them, and actual outcomes, whether

those outcomes are beneficial infrastructure developments, such as a repaved highway, or damaging and counterproductive excess in an overseas military operation. And they will be able to tie those outcomes to specific legislators' specific actions.

There is no guarantee that the DATA Act will be implemented well enough to produce such results. The law does not specify, for example, that each organizational unit of the federal government should have a unique identifier. Strikingly, the federal government today lacks a machine-readable organization chart. There is no single, consistent account of what agencies, bureaus, programs, and projects exist in the federal government. Having that information is as essential for government management and public oversight as having street addresses is for delivering mail. The lack of a coherent map of the federal government is part of the reason why it is so large (due to duplication) and so wasteful (due to opacity and failed oversight).

Full—and fully informative—implementation of the DATA Act will help cure the significant ailments of the federal government, allowing Congress to more effectively oversee the executive branch, the executive branch to more effectively manage itself, and the people to more effectively oversee both. But even the full implementation of the DATA Act and transparent data publication practices in general will not automatically deliver government transparency. Transparency also relies on the development of a community of websites, information services, and apps that process and broadcast data for public consumption. That type of robust transparency depends on the publication of data about government deliberations, management, and results in standardized, open formats.

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—Prepared by Jim Harper

Fiscal Policy

31. Averting National Bankruptcy

Congress should

- raise the age of eligibility for Medicare and Social Security;
- phase in higher deductibles and copayments for Medicare, Medicaid, and Obamacare; and
- freeze Social Security benefits per capita at the current (inflation-adjusted) value.

The United States debt is on an unsustainable path; that is, the United States is in (extreme) fiscal imbalance. In particular, the four main entitlement programs (Medicare, Medicaid, Obamacare, and Social Security) are collectively growing far faster than any plausible path for gross domestic product (GDP). Congress should curtail these programs to avoid fiscal Armageddon.

Background

The United States faces a challenging fiscal future. According to projections from the Congressional Budget Office (CBO), the debt-to-GDP ratio will hit at least 181 percent by 2090 and continue to climb unless the nation adjusts its tax and spending policies. If no policy changes occur and the debt ratio continues on its projected path for an extended period, the United States will eventually face rising interest rates on its debt, an even steeper debt path, and a fiscal crisis. This outcome is not inevitable; the United States likely has decades to adjust its policies. Few dispute, however, that unless the CBO's projections are substantially too pessimistic, the United States needs major adjustments in spending or tax policies to avoid fiscal meltdown.

Despite widespread agreement that spending or tax policies must change, however, appropriate adjustments have so far not occurred. Indeed, many

recent policy changes have worsened the U.S. fiscal situation. These include the creation of Medicare Part D ($65 billion in 2014); new subsidies under the Affordable Care Act, often called Obamacare ($13.7 billion in 2014); the expansion of Medicaid under Obamacare (from $250.9 billion in 2009 to $301.5 billion in 2014); higher defense spending (from $348.46 billion in 2002 to $603.46 billion in 2014); increased spending on veterans' benefits and services (from $70.4 billion in 2006 to $161.2 billion in 2014); and greater spending on energy programs (average annual spending rose from $0.52 billion over 1998–2002 to $11.43 billion over 2010–2014). Politicians across the spectrum, moreover, propose additional spending all the time.

"Fiscal imbalance" is the excess of what we expect to spend, including repayment of our debt, over what government expects to receive in revenue. A plausible explanation for America's failure to address its fiscal imbalance is a belief that "this time is no different," since earlier alarms have not ended in fiscal meltdown. In the 1980s, for example, the government experienced a large buildup of federal debt due to President Ronald Reagan's tax cuts and increases in military spending. Concern arose over the spiraling debt, causing congressional budget showdowns during President Bill Clinton's first term. But, ultimately, no serious fiscal crisis ensued.

In 2011, fears of a U.S. government default arose during the debt-ceiling crisis. Disagreements between members of Congress resulted in a political stalemate, massive public apprehension, and a one-notch downgrade of the U.S. credit rating. Just before the deadline, however, the Budget Control Act was signed into law, raising the debt ceiling by more than $2.1 trillion and staving off the threat of immediate default. A similar crisis loomed in 2013 when Congress's inability to rein in the federal deficit almost triggered a "fiscal cliff"—a series of deep, automatic cuts to federal spending. Once again, with only hours to spare, lawmakers reached a compromise and averted larger economic consequences. Overall, the past 30 years reveal a clear trend: time and time again, alarm erupts over the rising federal debt level, but full fiscal meltdown never materializes. Thus, many people dismiss claims that U.S. fiscal balance is a calamity in waiting, believing "this time is no different."

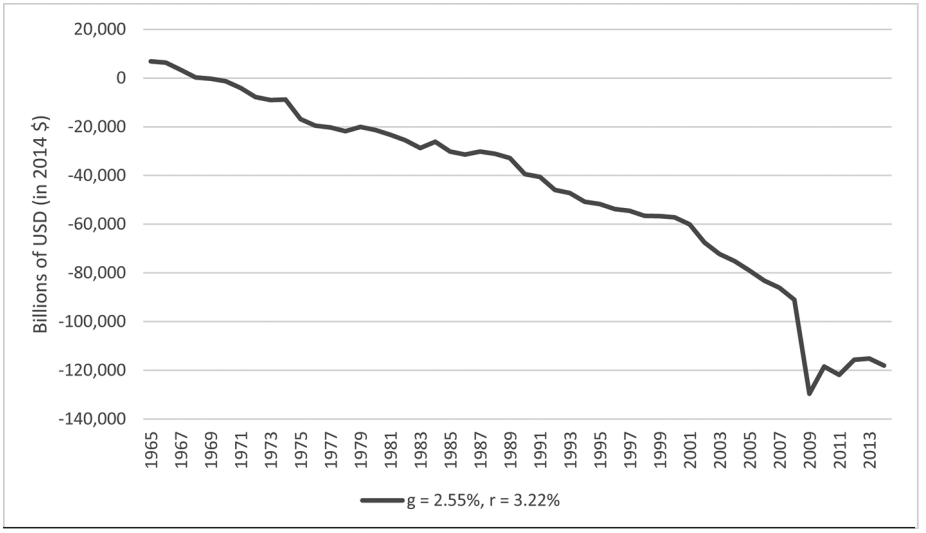
In truth, this time *is* different. Although fiscal meltdown is not imminent, the nation's fiscal situation has been deteriorating since the mid-1960s, is far worse than ever before, and will get worse as time passes and no adjustments occur. This view follows from looking not just at current deficits and the current value of the debt; these are incomplete measures

of the government's fiscal situation because they account only for past expenditure relative to tax revenue. The true impact of existing expenditure and tax policies depends as well on the projected paths of future expenditure and tax revenues. The standard measure of the overall fiscal situation is known as fiscal imbalance, which adds up (in a way that adjusts for interest rates) all future expenditures, minus future tax revenues, plus the explicit debt.

Figure 31.1 presents estimates of U.S. fiscal imbalance for the period 1965–2014. Imbalance has risen enormously from roughly zero in 1965 to $118 trillion in 2014, which is roughly seven times current GDP.

The reason for the persistent decline in fiscal balance is that the composition of federal expenditure has shifted markedly since 1965, especially from defense spending to mandatory health and retirement spending—that is, entitlements. Defense spending has declined relative to GDP over the post-WWII period; this spending could increase in the future but is unlikely to grow without bound. Entitlement spending, however, not only consumes a large fraction of the federal budget, it is also likely to grow

Figure 31.1
Projected Fiscal Imbalance, 1965–2014



NOTE: The estimates assume an average annual GDP growth rate (g) of 2.55 percent and real interest rate (r) of 3.22 percent, which reflect median growth and average interest rates over the past 40 years.

SOURCE: Jeffrey Miron, *U.S. Fiscal Imbalance over Time: This Time Is Different*. Washington: Cato Institute, 2016.

faster than GDP, indefinitely, under current law. This excess growth reflects the increasing share of the population collecting benefits relative to younger people paying taxes, as well as the impact of subsidized health insurance on health care cost inflation. Thus, CBO forecasts that health and retirement spending will increase substantially faster than GDP going forward.

In principle, the United States has three options for restoring fiscal balance: faster economic growth, higher taxes, or slower expenditure growth. In practice, only slower growth of entitlement spending can make a significant difference. Even if economic growth achieved its highest historical levels, that would not alter imbalance materially. Similarly, even if taxes were raised substantially above their postwar average—and had no adverse effect on growth—fiscal imbalance would still be large.

That leaves expenditure cuts as the only viable way to significantly reduce fiscal imbalance. And the cuts must target entitlements, since those programs are large and are the ones growing relative to GDP. The crucial difference between expenditure cuts and tax hikes is that the former could plausibly increase growth, by reducing distortions in health and retirement decisions, while the latter would almost certainly reduce growth, making imbalance worse. Thus, cutting the growth of federal health and retirement expenditure is a win-win. Congress has three main options for cutting entitlements and averting bankruptcy.

Raise the Eligibility Age for Social Security and Medicare

The original justification for Social Security and Medicare was to help citizens who could no longer care for themselves. When Congress created Social Security in 1935, life expectancy was 63 and the age of eligibility was 65, so Social Security was insurance against "living too long." Similarly, when Congress adopted Medicare in 1965, life expectancy was about 70 and the age of eligibility was again 65, so most beneficiaries expected only a few years of subsidized health care. Today's average life expectancy, however, has reached nearly 79. Social Security's age of "normal retirement" has increased by only two years since 1965, and Medicare's is still 65. Unsurprisingly, the total number of Social Security beneficiaries has skyrocketed; 25 million Americans received Social Security benefits in 1970, compared with 60 million in 2015.

Thus, as life expectancy has steadily increased, and health conditional on age has improved, Social Security and Medicare have evolved from helping only those in serious need to also providing income support and

subsidized health insurance, over decades, for middle- and upper-income households. Simultaneously, the fraction of the population receiving benefits has grown relative to the fraction paying taxes, making these programs fiscally unsustainable. Thus, under current parameters, both programs have grown far beyond their original intent and have become unaffordable.

Congress should raise the age of eligibility in both programs, by at least enough to offset the increase in life expectancy since creation of the programs. The higher ages could be phased in gradually, for example, by six months every year for some number of years, with the higher age affecting only those below some cutoff, such as age 50. Thus, the higher eligibility ages would not affect those already receiving benefits or even those within 15 years of (current) eligibility. Congress should also index the eligibility age to future increases in life expectancy; this would avoid future expansions of Social Security and Medicare relative to the size of the economy.

Increase Deductibles and Copayments for Medicare, Obamacare, and Medicaid

Standard economics explains that people demand health insurance to protect themselves financially in the case of major illnesses or accidents, not to cover routine expenditures such as for checkups, medications, and other moderate and predictable outlays. This implies that economically efficient health insurance should have substantial deductibles.

Standard economics also suggests that economically efficient health insurance should come with significant copays. Insurance can generate excessive health expenditure because the insured do not pay the costs of their care (a phenomenon known as moral hazard). One remedy is deductibles; a second is copays, the portion of health expenditure paid by the insured person, after the deductible has been met. Copays do not fully balance the costs of care against the benefits, but they nudge health care decisions in the right direction while still reducing the risk of large outlays for the insured.

Thus, Congress should modify Medicare, Obamacare, and Medicaid to incorporate significantly higher deductibles and copays. The appropriate adjustments differ across programs, but increases of at least 50 to 100 percent, or more, make sense in many cases. For example, the yearly deductible for Medicare Part A is only $1,288 and for most Part B benefits, only $166. Obamacare caps yearly out-of-pocket spending for deductibles and copays at $6,850 for self-only coverage and $13,700 for family cover-

age. Medicaid charges minimal copays for those below 150 percent of the federal poverty level.

Freeze (Real) Social Security Benefits

Under current policy, the level of Social Security benefits that an individual receives is a function of that individual's earnings history. In market economies, wages tend to rise with worker productivity (which in turn reflects technological progress); so as an economy experiences productivity growth, real wages rise. Thus, the inflation-adjusted level of Social Security benefits grows along with the economy's increase in overall productivity. Indeed, over the past four decades, the average annual Social Security benefit (in real terms) has more than doubled, from $7,200 per recipient in 1970 to $14,900 in 2015 (constant 2015 dollars).

Assuming Social Security exists to prevent poverty, the ongoing increase in benefit levels is excessive. Instead, society should determine a level of benefits that allows those without other income to attain some modest standard of living; Congress should keep that level in place over time.

Congress should therefore freeze the level of real benefits at its current value; this amounts to indexing the level of new benefits to price rather than wage inflation. Under this approach, Social Security expenditure would grow far more slowly than under the current system because it would only reflect increases in the population age 65 and over, rather than also increasing with productivity.

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—Prepared by Jeffrey Miron

32. Cutting Federal Spending

Congress should

- cut federal spending from 21 percent of gross domestic product to less than 18 percent to balance the budget and begin paying down the debt;
- terminate damaging programs, such as farm subsidies and corporate welfare;
- privatize activities that can be funded in the marketplace, such as postal services, passenger rail, electric utilities, and air traffic control;
- phase out aid-to-state programs, including those for education, housing, transportation, and welfare;
- cut traditional Social Security benefits and replace them with private retirement accounts;
- move to a Medicare system based on individual savings, competition, and choice;
- convert Medicaid to a block grant and cap spending growth; and
- repeal the Affordable Care Act.

Federal government spending is rising, deficits are chronic, and accumulated debt is reaching dangerous levels. Growing spending and debt are undermining economic growth and may push the nation into a financial crisis in coming years. The solution to these problems is to downsize every federal department by cutting the most harmful and unneeded programs. This chapter proposes specific cuts that would balance the budget and reduce projected spending by almost one-quarter within a decade.

Over recent decades, the federal government has expanded into many areas that should be left to state and local governments, businesses, charities,

and individuals. That expansion is sucking the life out of the private economy and creating a top-down bureaucratic society that is alien to American traditions.

Federal spending cuts would revive growth by shifting resources from lower-valued government activities to higher-valued private ones. Cuts would also enhance civil liberties by dispersing power away from Washington. And cuts would help reduce the number of costly regulations that are imposed as part of spending programs.

The Congressional Budget Office (CBO) projects that federal spending will rise from 21.1 percent of gross domestic product (GDP) this year to 23.1 percent by 2026 under current law. Over the same period, tax revenues will rise more modestly, reaching 18.5 percent of GDP in 2026. As a consequence, rising spending will produce increasingly large deficits.

Policymakers should change course. They should cut spending and eliminate deficits. The plan presented here would balance the budget over time and generate growing surpluses. Spending would be reduced to 17.7 percent of GDP by 2026, or almost one-quarter less than the CBO projection for that year.

Some economists claim that cutting government spending would hurt the economy, but that notion is based on faulty Keynesian theories. In fact, spending cuts would shift resources from often mismanaged and damaging government programs to more productive private activities, thus increasing overall GDP. Markets have mechanisms to allocate resources to high-value activities, but the government has no such capabilities.

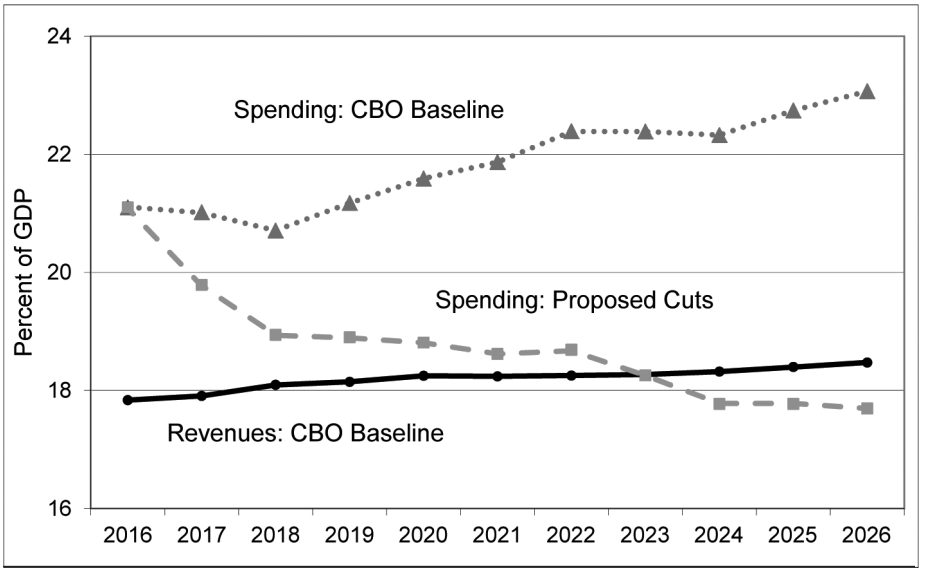
It is true that private businesses make many mistakes, but entrepreneurs and competition are constantly fixing them. By contrast, federal agencies follow failed and obsolete approaches decade after decade. That is why moving resources out of the government would be a net gain for the overall economy.

Policymakers should not think of spending cuts as a necessary evil to reduce deficits. Rather, the federal government's fiscal mess is an opportunity to implement reforms that would spur growth and expand freedom. The plan proposed here includes a menu of possible spending reforms. These and other reforms are discussed further at DownsizingGovernment.org.

Spending Cut Overview

The starting point for a spending cut plan is the CBO's baseline budget projections. Figure 32.1 shows CBO projections from August 2016 for

Figure 32.1
Projected Federal Revenues and Spending, Percentage of GDP



SOURCE: Author's calculations.

revenues (solid line) and spending (dotted line) as a percentage of GDP. The gap between the two lines is the federal deficit, which is expected to grow steadily without reforms.

The dashed line shows projected spending under the reform plan proposed here. Under the plan, spending would decline from 21.1 percent of GDP in 2016 to 17.7 percent by 2026. The deficit would be eliminated by 2023, and growing surpluses would be generated after that. Spending cuts would be phased in over 10 years and would total $1.5 trillion annually by 2026, including reduced interest costs.

Falling spending and deficits would create budget room for tax reforms. One reform would be to repeal the tax increases under the 2010 Affordable Care Act. Another reform would be to slash the federal corporate tax rate from 35 percent to 15 percent to match the federal rate in our largest trading partner, Canada. Such a cut would spur stronger growth, boost worker wages as businesses increased investment, and lose little revenue over the long term.

Spending Cut Details

Tables 32.1 and 32.2 list proposed cuts to reduce federal spending to 17.7 percent of GDP by 2026. Table 32.1 shows cuts for health care and

Table 32.1
Proposed Federal Budget Cuts: Health Care and Social Security

Agency and Activity	Annual Savings $billions, 2026
Health Care	
Repeal Affordable Care Act exchange subsidies	103
Repeal Affordable Care Act Medicaid expansion	122
Block grant Medicaid and grow at 2%	128
Increase Medicare premiums	63
Increase Medicare cost sharing	20
Cut Medicare improper payments by 50%	78
Cut non-Medicaid state health grants by 50%	47
Total cuts	**561**
Social Security Administration	
Price index initial Social Security benefits	39
Raise the normal retirement age for Social Security	10
Cut Social Security Disability Insurance by 25%	54
Cut Supplemental Security Income by 25%	18
Total cuts	**121**
Total annual spending cuts in 2026	**$682**

SOURCE: Author's calculations.

Social Security. Those reforms would be implemented right away, but the value of savings would grow over time. The figures shown are the estimated annual savings by 2026, generally based on CBO projections.

Table 32.2 shows cuts to programs other than health care and Social Security. These cuts would be valued at $458 billion in 2016, but the plan assumes that they would be phased in one-tenth each year over the next decade.

The reforms listed in Tables 32.1 and 32.2 are deeper than the savings from "duplication" and "waste" often mentioned by policymakers. We should cut hundreds of billions of dollars of "meat" from federal departments, not just the obvious "fat." If the activities that are cut are useful to society, then state governments or private groups should fund them, and they would be more efficient doing so than the federal government.

Table 32.2
Proposed Federal Budget Cuts
Discretionary Programs and Other Entitlements

Agency and Activity	Annual Savings $billions, 2016
Department of Agriculture	
End farm subsidies	29.3
Cut food subsidies by 50%	53.5
End rural subsidies	6.5
Total cuts	**89.3**
Department of Commerce	
End telecom subsidies	0.6
End economic development subsidies	0.4
Total cuts	**1.0**
Department of Defense	
End overseas contingency operations	59.0
Total cuts	**59.0**
Department of Education	
End K-12 education grants	25.3
End all other programs	53.8
Total cuts (terminate the department)	**79.1**
Department of Energy	
End subsidies for renewables	2.2
End fossil/nuclear/electricity subsidies	1.9
Privatize power marketing administrations	0.8
Total cuts	**4.9**
Department of Homeland Security	
Privatize TSA airport screening	4.9
Devolve FEMA activities to the states	16.6
Total cuts	**21.5**
Department of Housing and Urban Development	
End rental assistance	30.5
End community development subsidies	11.0
End public housing subsidies	5.8
Total cuts (terminate the department)	**47.3**

(continued)

Table 32.2
(continued)

Agency and Activity	Annual Savings $billions, 2016
Department of the Interior	
Reduce net outlays by 50% through spending cuts, privatization, and user charges	7.0
Total cuts	**7.0**
Department of Justice	
End state/local grants	6.7
Total cuts	**6.7**
Department of Labor	
End employment and training services	3.6
End Job Corps	1.6
End trade adjustment assistance	0.8
End Community Service for Seniors	0.4
Total cuts	**6.4**
Department of Transportation	
Cut highway/transit grants to balance trust fund	12.0
Privatize air traffic control (federal fund savings)	2.1
Privatize Amtrak and end rail subsidies	3.6
Total cuts	**17.7**
Department of the Treasury	
Cut earned income tax credit by 50%	30.7
End refundable part of child tax credit	21.6
End refundable part of Am. Opp. Tax Credit	4.4
Total cuts	**56.7**
Other Savings	
Cut foreign aid by 50%	8.0
Cut federal civilian compensation costs by 10%	32.9
Privatize the Army Corps of Engineers (Civil Works)	6.7
Privatize the Tennessee Valley Authority	0.5
Privatize the U.S. Postal Service	n/a
Repeal Davis-Bacon labor rules	9.0
End EPA state/local grants	4.1
Total cuts	**61.2**
Total annual spending cuts	**$457.8**

SOURCE: Author's calculations.

The proposed cuts to subsidies, aid to the states, military spending, and entitlement programs are discussed below. The final section discusses the privatization of federal activities. Further analyses of these and other cuts are at DownsizingGovernment.org.

Subsidies to Individuals and Businesses

The federal government funds about 2,300 subsidy programs, more than twice as many as in the 1980s, according to my analysis of the *Catalog of Federal Domestic Assistance*. The *scope* of federal activities has expanded in recent decades along with the *size* of the federal budget. The federal government subsidizes farming, health care, school lunches, rural utilities, the energy industry, rental housing, aviation, passenger rail, public broadcasting, job training, foreign aid, urban transit, and many other activities.

Each subsidy causes damage to the economy through the required taxation. And each subsidy generates a bureaucracy, spawns lobby groups, and encourages even more people to demand government handouts. Individuals, businesses, and nonprofit groups that become hooked on federal subsidies essentially become tools of the state. They lose their independence, have less incentive to work and innovate, and shy away from criticizing the government.

Table 32.2 includes cuts to subsidies in agriculture, commerce, energy, housing, foreign aid, and other activities. Those cuts would not eliminate all of the unjustified subsidies in the budget, but they would be a good start. Government subsidies are like an addictive drug, undermining America's traditions of individual reliance, voluntary charity, and entrepreneurialism.

Aid to the States

Under the Constitution, the federal government was assigned specific limited powers, and most government functions were left to the states. Unfortunately, policymakers and the courts have mainly discarded constitutional federalism in recent decades. Through "grants-in-aid" Congress has undertaken many activities that were traditionally reserved to state and local governments. Grant programs are subsidies that are combined with federal regulatory controls to micromanage state and local activities. Federal aid to the states totals about $700 billion a year and is distributed through more than 1,100 separate programs.

The theory behind grants-in-aid is that the federal government can operate programs in the national interest to efficiently solve local problems.

However, the aid system does not work that way in practice. Most federal politicians are preoccupied by the competitive scramble to maximize subsidies for their states, and they generally ignore program efficiency and overall budget limitations.

Furthermore, federal aid stimulates overspending by state governments and creates a web of complex federal regulations that undermine state innovation. At all levels of the aid system, the focus is on spending and regulatory compliance, not on delivering quality public services. The aid system destroys government accountability because each level of government blames the other levels when programs fail. It is a triumph of expenditure without responsibility.

The grants-in-aid system is a roundabout funding system for state and local activities. It serves no important economic purpose, and it should be eliminated. Tables 32.1 and 32.2 include cuts to state grants for education, health care, highways, justice, transit, and other activities. There is no reason why such activities should not be funded by state and local governments or the private sector.

Military Spending

Cato Institute defense experts Christopher Preble and Benjamin Friedman have proposed numerous cuts to U.S. military spending (see Chapter 68). They argue that the United States would be better off taking a wait-and-see approach to distant threats, while letting friendly nations bear more of the costs of their own defenses. They note that U.S. policymakers support many extraneous missions for the military aside from the basic role of defending the nation.

As such, the military budget should be cut in a prudent fashion as part of an overall plan to downsize the government and balance the budget. The plan proposed here assumes that spending on overseas contingency operations—which will be $59 billion in 2016—would be reduced to zero over time.

Medicare, Medicaid, and Social Security

The projected growth in Medicare, Medicaid, and Social Security is the main cause of America's looming fiscal crisis. Budget experts generally agree on the need to restructure these programs, and Table 32.1 includes a variety of reforms.

Policymakers should repeal the 2010 Affordable Care Act. That would reduce spending on Medicaid and end spending on the exchange subsidies.

In addition, policymakers should convert Medicaid from an open-ended matching grant to a block grant, while giving state governments more program flexibility. That was the successful approach used for welfare reform in 1996, which encouraged state innovation.

Table 32.1 includes modest Medicare changes based on CBO estimates. Reforms include increasing deductibles and increasing premiums for Part B to cover 35 percent of the program's costs. It also assumes that the Medicare improper payment rate would be cut in half to 6 percent.

However, larger Medicare reforms are needed than just these cuts. Cato scholars have proposed moving to a system based on individual vouchers, personal savings, and consumer choice for elderly health care (see Chapter 38). Such a reform would create incentives for patients to become more discriminating consumers of health services and providers to improve system quality and reduce costs.

For Social Security, initial benefits should be indexed to prices rather than wages to slow the program's growth. The plan also includes a CBO option to modestly raise the normal retirement age. In addition, the fraud-plagued Social Security Disability Insurance and Supplemental Security Income programs would be trimmed 25 percent compared with current spending projections.

In addition to these reforms, Social Security should be transitioned to a system of private accounts, as discussed in Chapter 40. Private accounts would increase fairness, boost personal financial security, and improve work incentives by partly converting payroll taxes into contributions to accounts that are personally owned.

Privatization

A privatization revolution has swept the world since the 1980s. Following Britain's lead, governments in more than 100 countries have transferred thousands of state-owned businesses to the private sector. More than $3 trillion of railroads, energy companies, postal services, airports, and other businesses have been privatized.

Privatization helps spur economic growth. It allows entrepreneurs and markets to reduce costs, improve service quality, and increase innovation. It also benefits the environment by reducing the wasteful use of resources.

Despite the global success of privatization, reforms have largely bypassed our own federal government. Many activities that have been privatized abroad remain in government hands in this country. U.S. policymakers should learn from foreign privatization and enact proven reforms here.

Table 32.2 includes the privatization of Amtrak, the air traffic control system, airport screening, electric utilities, the Army Corps of Engineers, and the U.S. Postal Service. Such reforms would reduce budget deficits and improve management, as described in related chapters and at Down sizingGovernment.org.

Conclusions

CBO's long-term baseline projections show that federal spending and debt will rise continuously in coming years as a share of GDP, which will undermine economic growth and cause a serious financial crisis at some point. The sooner that policymakers tackle major spending reforms, the better to avoid accumulating even more debt. Leaders of numerous other nations have pursued vigorous cost cutting when their spending and debt started getting out of control. There is no reason why our political leaders cannot do the same.

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—Prepared by Chris Edwards

33. Infrastructure Investment

Congress should

- privatize federally owned infrastructure, including passenger rail, electric utilities, power dams, and air traffic control;
- cut federal aid for highways, urban transit, airports, and other infrastructure that is owned by state and local governments;
- free the states from federal regulations that needlessly raise costs on infrastructure projects, such as many labor and environmental rules; and
- reform federal laws that impede the privatization of state and local infrastructure.

The importance of infrastructure investment to the U.S. economy is widely recognized. But policy discussions usually focus on the level of spending and ignore the efficiency by which investment is allocated and projects are built and operated. Efficiency and innovation would increase if the federal role were reduced. State and local governments and the private sector are more likely to make sound infrastructure decisions without federal intervention.

Government Infrastructure in Perspective

The word "infrastructure" refers to long-lived fixed assets that provide a backbone for other activities in the economy. In the United States, most infrastructure is provided by the private sector, not governments. In 2015, gross fixed private nonresidential investment was $2.3 trillion, according to the Bureau of Economic Analysis. That includes investment in factories, freight rail, pipelines, refineries, power plants, cell towers, satellites, and many other items.

By contrast, total federal, state, and local government infrastructure investment in 2015 was $613 billion. Excluding national defense, government investment was $472 billion. Thus private infrastructure investment—broadly defined—is about five times as large as total nondefense government investment in infrastructure.

One implication of the data is that if policymakers want to strengthen the nation's infrastructure, they should enact reforms that spur private investment. In particular, they should consider reductions in regulations and business tax rates, which would increase the net returns to a broad range of private infrastructure and thus spur greater investment spending.

Government investment in infrastructure, though smaller than private, is nevertheless important to the economy, and we should ensure that it is adequately funded. Many pundits say that America is underinvesting in public infrastructure and that our highways and bridges are crumbling. Such claims are off base. For one thing, government investment as a share of gross domestic product in the United States is similar to the average share among nations in the Organization for Economic Cooperation and Development (OECD). Over the past three years, the U.S. and OECD averages have both been 3.4 percent.

Also, rather than crumbling, some of our public infrastructure has steadily improved. Federal Highway Administration (FHWA) data on bridges show steady gains. Of the roughly 600,000 bridges in the country, the share that are "structurally deficient" has fallen from 22 percent in 1992 to 10 percent in 2015, while the share that are "functionally obsolete" has fallen from 16 percent to 14 percent.

Similarly, the surface quality of the interstate highways has improved. Examining FHWA data, Federal Reserve of Chicago economists found that "since the mid-1990s, our nation's interstate highways have become indisputably smoother and less deteriorated." They concluded that the interstate system is "in good shape relative to its past condition."

Nonetheless, America does face infrastructure challenges. Highway congestion imposes a large cost on the economy. Highways and bridges are aging. Our airports and seaports need investments to meet rising demands. State and local governments and the private sector—not the federal government—can best address these challenges.

Problems with Federal Intervention

There are frequent calls for increased federal spending on infrastructure, but advocates ignore the inefficiencies and failures of past federal efforts. Here are some of the problems:

- **Investment is misallocated.** Federal investments are often based on pork-barrel and bureaucratic factors rather than marketplace demands. Amtrak investment, for example, is spread around to low-population regions where passenger rail makes no economic sense. Lawmakers all want an Amtrak route through their state, so investment gets steered away from where it is really needed, such as the Northeast corridor.
- **Infrastructure is utilized inefficiently.** Government infrastructure is often used inefficiently because supply and demand are not balanced by market prices. The vast water infrastructure operated by the Bureau of Reclamation, for example, underprices irrigation water in the western United States. The result is wasted resources, harm to the environment, and a looming water crisis in many areas in the West.
- **Projects are mismanaged.** Unlike private businesses, governments don't have strong incentives to ensure that projects are constructed efficiently. Federally funded highway, transit, airport, and air traffic control projects often have large cost overruns. The budget for the "Big Dig" in Boston—which was two-thirds funded by the federal government—exploded to five times the original cost estimate. And over the decades, the Army Corps of Engineers and Bureau of Reclamation have built numerous projects that were economic and environmental boondoggles.
- **Mistakes are replicated across the nation.** When Washington makes infrastructure mistakes, it replicates them across the nation. High-rise public housing projects, for example, were a terrible idea that federal funding spread nationwide. More recently, federal subsidies for light-rail projects have biased cities in favor of these expensive systems, even though they are generally less efficient and flexible than bus systems.
- **Burdensome regulations.** Federal infrastructure aid comes part and parcel with costly regulations. Federal Davis-Bacon rules raise the labor costs of building state and local infrastructure. The rules inflate wages on highway projects by about one-fifth. Federal environmental rules also impose costs on transportation projects. The number of environmental laws affecting transportation projects has risen from about 20 in 1970 to about 70 today, according to the FHWA.

The solution to these problems is to privatize federally owned infrastructure, cut federal aid to the states, and reduce federal regulations so that the states can tackle their infrastructure challenges in the most efficient manner.

Privatizing Federal Infrastructure

A privatization revolution has swept the world since the 1980s. Governments in more than 100 countries have transferred thousands of state-owned businesses worth more than $3 trillion to the private sector. Railroads, airports, seaports, energy utilities, and other infrastructure businesses have been privatized.

Despite the global success of privatization, reforms have largely bypassed our own federal government. Infrastructure that has been privatized abroad remains in government hands in this country. Congress should study foreign reforms and privatize the following infrastructure assets:

- **Air traffic control.** The Federal Aviation Administration has struggled to modernize our air traffic control (ATC) system. ATC is a high-technology industry, but we still run it as an old-fashioned bureaucracy. Meanwhile, Canada privatized its ATC system in 1996 as a self-funded nonprofit corporation. Today, the Canadian system is highly efficient and one of the safest in the world. The Canadians are on the leading edge of ATC technologies, and they sell their innovations worldwide.
- **Tennessee Valley Authority.** One of the largest utilities in the nation is owned by the federal government. The Tennessee Valley Authority (TVA) has a bloated cost structure and a poor environmental record, and it has wasted billions of dollars on its nuclear program. Electric utilities have been privatized around the world, so privatizing TVA should be a no-brainer.
- **Amtrak.** The government's passenger rail company has a costly union workforce and a poor on-time record, and it loses more than a billion dollars a year. A lot of the losses come from running trains on routes with low ridership. Congress should privatize Amtrak and give entrepreneurs a crack at creating a better system.
- **Power Marketing Administrations.** The federal government owns four Power Marketing Administrations (PMAs), which transmit wholesale electricity in 33 states. The power is mainly generated by hydroelectric plants owned by the Army Corps of Engineers and the Bureau of Reclamation. The PMAs receive numerous subsidies and sell most of their power at below-market rates. Congress should privatize the PMAs and the hydro plants.
- **Army Corps of Engineers.** The civilian part of the Army Corps constructs and maintains water infrastructure such as locks, waterways,

and flood control structures. But the Corps is filling roles that private engineering and construction companies could fill. When the states need to construct and maintain levees, harbors, beaches, inland waterways, and recreational areas, they should hire private companies to do the work. The Army Corps should be privatized and compete for such work.

- **Bureau of Reclamation.** This agency builds and operates dams, canals, and hydro plants in the 17 Western states. It is the largest wholesaler of water in the nation. Reclamation subsidizes irrigation water, which distorts the economy and causes environmental harm. The agency's facilities should be transferred to state ownership or privatized.

States Should Lead on Infrastructure

When considering investments in highways and transit, people often assume that Washington needs to lead the effort. Many advocates support raising the federal gas tax to fund more highway and transit spending.

However, the nation's interstate highways, other highways, bridges, and transit systems are virtually all owned by state and local governments. The states can raise their own gas taxes to fund their transportation facilities anytime they want. Indeed, about half the states have raised their gas taxes or other transportation revenues over the past five years.

Furthermore, state governments have other options to finance their infrastructure. A growing trend around the world is partial privatization of infrastructure through public-private partnerships (P3s). P3s differ from traditional government contracting by shifting elements of financing, management, operations, and project risks to the private sector.

Infrastructure P3s have many advantages. When private businesses are taking some of the risks and putting their profits on the line, funding is more likely to be allocated to high-return projects and completed in an efficient manner. U.S. and foreign empirical studies find that privately financed infrastructure projects are more likely than traditional government projects to be completed on time and on budget.

Another issue is that the usual process of government contracting decouples construction from the future management of facilities. As a result, contractors have no incentive to build projects that minimize long-term costs. P3s solve this problem because the same company both builds and operates new facilities. Another advantage of P3s is that businesses can tap capital markets to build capacity and meet market demands—thus avoiding the instability of government budgeting.

P3s are a global trend, but the United States lags Australia, Canada, and other nations in pursuing this innovative approach. Nonetheless, some U.S. states have pursued P3s. In Virginia, a private partnership built and is now operating toll lanes along 14 miles of the Capital Beltway, I-495. The partnership used debt and equity to finance most of the project's $2 billion cost. The lanes were completed on time and on budget in 2012.

P3s are a means to partially privatize, but full privatization is also possible for some infrastructure. In Virginia, the Dulles Greenway is a privately owned toll highway completed in the mid-1990s with $350 million of private debt and equity. Also in Virginia, the FIGG Engineering Group financed and constructed the $142 million Jordan highway bridge over the Elizabeth River. The bridge opened in 2012, and investors are being paid back over time from toll revenues.

Unfortunately, such private infrastructure projects are rare in the United States. Consider that dozens of major airports around the world have been privatized, yet virtually all commercial airports in this country are owned by state and local governments. A key problem is that the federal government creates barriers to state and local privatization.

Removing Barriers to State and Local Privatization

Despite the benefits of private infrastructure, federal policies create hurdles to private sector investments. Congress should address the following issues:

- **Tax exemption on municipal bond interest.** When state and local governments borrow funds to build infrastructure, the interest on the debt is tax free under federal income tax rules. That allows governments to finance infrastructure at a lower cost than private businesses can, which stacks the deck against the private provision of facilities such as airports. Congress should repeal the tax exemption on state and local bond interest to level the playing field.
- **Federal subsidies.** Federal subsidies tilt state and local lawmakers in favor of government provision of infrastructure. Private airports, for example, are generally not eligible for federal airport subsidies. Or consider urban transit. Before the 1960s, most bus and rail services in America were privately owned and operated. But that ended with the passage of the Urban Mass Transportation Act of 1964. That act provided subsidies only to government-owned bus and rail systems, not private systems. The change prompted governments across the

country to take over private systems, ending more than a century of private transit in our cities. Congress should end federal aid for state and local infrastructure.

- **Federal regulations.** Various federal regulations restrict state and local privatization. For example, states that have received federal aid for their facilities are generally required to repay the past aid if facilities are privatized. Another issue is that tolling is generally prohibited on existing interstate highways, a ban that has reduced the scope for P3 projects. Congress should eliminate these and other regulations that stand in the way of infrastructure privatization.

To conclude, America should strive for top-notch infrastructure in order to compete in the global economy. The best way forward is to reduce federal intervention and devolve control over infrastructure to the states and private sector. The states themselves should innovate with P3s and full privatization. Governments should encourage entrepreneurs to enter the fray with new ideas for meeting the nation's infrastructure demands.

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—Prepared by Chris Edwards

34. Global Tax Competition

Congress should:

- end incentives for corporate inversions by lowering the corporate tax rate and shifting to territorial taxation;
- repeal the Foreign Account Tax Compliance Act;
- eliminate subsidies for the Organization for Economic Cooperation and Development;
- reject proposals to force American banks to help enforce foreign tax law; and
- not ratify the Protocol Amending the Convention on Mutual Administrative Assistance in Tax Matters.

Tax competition exists when taxpayers have the ability to reduce their fiscal burdens by moving themselves, their businesses, and/or their money from high-tax jurisdictions to low-tax jurisdictions. When this freedom exists, politicians are much more cautious about raising taxes because of fears that the geese with the golden eggs will fly away. Indeed, the existence of tax competition often leads to lower tax rates. Tax competition can exist inside a nation, with American states and Swiss cantons being notable—and mostly noncontroversial—examples.

Fiscal competition between nations, by contrast, generates considerable controversy. High-tax nations, along with international bureaucracies controlled by those nations (such as the Organization for Economic Cooperation and Development [OECD] and the European Commission), would like to stifle this liberalizing process. So-called "tax havens" are the main target of efforts to replace tax competition with tax harmonization.

The Historical Record

The angst of politicians is understandable. Consider what happened after Ronald Reagan lowered the top federal income tax rate in the United

States from 70 percent to 28 percent, and after Margaret Thatcher lowered the top tax rate in the United Kingdom from 83 percent to 40 percent. Those reforms led to an economic renaissance in the two nations. But those tax cuts also encouraged similar tax-rate reductions all over the world as politicians in other nations felt pressure to improve their tax systems to prevent a big exodus of jobs, investment, and money to the United States and the United Kingdom.

The same thing happened with corporate tax rates, except that Ireland probably deserves most of the credit. Ireland slashed its corporate tax rate from 50 percent to 12.5 percent over about a 15-year period starting in 1987. The "sick man of Europe" became the "Celtic Tiger" because of rapid growth. That was good news in itself, but it also has been good news because pro-growth reforms in Ireland triggered a competitive battle as other nations cut their corporate rates to retain jobs and investment.

Thanks in part to tax competition, there has also been a flat-tax revolution. More than two dozen nations now have single-rate tax systems, mostly triggered by Estonia's reform in the 1990s. The other Baltic nations copied Estonia and now this pro-growth system is very common among the nations that were part of the former Soviet empire.

Last but not least, there have been significant reductions in the double taxation of saving and investment in recent decades. Tax competition among nations has resulted in lower tax rates on interest, dividends, and capital gains, thus ameliorating the common bias in many tax systems against income that is saved and invested. Death taxes and wealth taxes also have been reduced or eliminated as politicians decided it made no sense to drive capital to other nations.

All of these examples of tax competition have been facilitated by globalization. It's now much easier for jobs and investment to cross national borders, so politicians have to be especially sensitive to the impact of potential tax changes. In other words, governments no longer can act like monopolists, assuming that taxpayers have no choice but to submit to punitive tax regimes. And since lower tax rates and reductions in double taxation are key ways of reducing the harmful impact of tax systems, the process of jurisdictional competition has been very beneficial to the global economy.

The (High-Tax) Empire Strikes Back

High-tax nations have launched a counter-offensive against international tax competition. Most notably, they are using the Paris-based Organization

for Economic Cooperation and Development as their vehicle for a campaign that supposedly targets tax havens. These efforts are based on a theory that presumes all tax competition is bad and taxpayers should never be allowed to benefit from better tax laws in other jurisdictions.

That theory, known as "capital export neutrality," promotes tax harmonization such that taxpayers never have an opportunity to make choices that would reduce their fiscal burdens. There are two ways to make this happen, directly and indirectly.

Direct tax harmonization exists when all nations agree to have the same tax rates. The requirement that all European Union (EU) nations have a value-added tax of at least 15 percent would be an example of this approach. And when all nations have the same tax rate for a type of economic activity, taxpayers obviously cannot lower their tax burdens by shifting economic activity to another jurisdiction.

Indirect tax harmonization exists when nations have the ability to impose and enforce "worldwide taxation," which means that their tax authorities can obtain all the information needed to tax their citizens on any cross-border economic activity. And when worldwide taxation is enforceable, taxpayers obviously cannot lower their tax burdens by shifting economic activity to another jurisdiction.

The OECD and high-tax nations have mostly focused on the second form of tax harmonization, which explains the strong push to undermine human-rights laws regarding financial privacy in places such as Switzerland and the Cayman Islands. High-tax governments want the ability to track capital around the world so they can impose additional layers of tax.

There have also been periodic efforts to promote direct tax harmonization, particularly in the European Union where there is considerable cartel-like equalization of excise taxes and (as noted above) value-added taxes. In addition, the EU has tried several times to explicitly harmonize corporate tax rates. Today, the EU is pursuing a "common consolidated corporate tax base" in hopes of undermining tax competition for company investment. The OECD has a similar "base erosion and profit shifting" initiative that also is designed to enable higher tax burdens on companies.

American Hypocrisy on Tax Havens

The policies of the United States are hypocritical on the issue of tax competition. On the one hand, America has a very aggressive worldwide tax system. The internal revenue code imposes worldwide taxation on labor income of Americans, mitigated by a "Section 911" exclusion that

protects those with modest incomes. The internal revenue code also imposes worldwide taxation on corporate income, mitigated by "deferral," a policy that allows companies to postpone the extra layer of tax. And the internal revenue code imposes worldwide taxation on individual capital income (interest, dividends, capital gains, etc.), with no meaningful limits.

Because of these policies, the United States has been very aggressive in bullying other jurisdictions into enforcing bad American tax law. Jurisdictions considered to be tax havens have been coerced into signing "tax information exchange agreements" with the United States. Of course, these pacts don't actually involve any "exchange" since these jurisdictions generally don't try to tax outside their borders. The Foreign Account Tax Compliance Act, adopted back in 2010, uses the threat of a protectionist 30 percent tax on financial flows to force all nations (even places like France, which has very high tax burdens) into acting as deputy tax collectors for the Internal Revenue Service (IRS).

On the other hand, the United States is a tax haven for foreigners. People from other nations (technically, "nonresident aliens") generally can invest in stocks and bonds and not be taxed on any interest or capital gains. And since that money isn't taxed, there's no requirement to provide any data to the IRS. That means there's no information to share with foreign governments. The United States may not have strong human rights laws that explicitly protect the privacy of foreign investors, but the combination of nontaxation and nonreporting makes America an attractive de facto tax haven.

But that's only part of the story. Many American states have incorporation laws that are extremely attractive to foreigners who want confidential structures for conducting business and managing investments. Indeed, some American states don't even bother collecting information on ownership, so there's no information to share with foreign governments.

This combination of federal tax law and state incorporation laws makes the United States a very attractive place for foreigners seeking to escape excessive tax burdens. And it also happens to be a boon for the American economy. According to the Commerce Department, foreigners have more than $13 trillion in indirect investments in the United States.

Issues for Congress

Here are some tax competition-related issues that are receiving congressional attention.

Corporate Inversions

America's very high corporate tax rate, combined with a very harsh worldwide tax system, makes the United States arguably the worst place in the world to base a multinational company. But if firms can "redomicile" (i.e., move their charters from states like Delaware to jurisdictions such as Ireland, Switzerland, Cayman Islands, or Bermuda), they can protect themselves from the competitive disadvantage of being taxed a second time on their foreign-source income. This process is called an inversion, and it can cause people to engage in victim blaming, accusing the companies of somehow being unpatriotic (even though the companies generally keep their headquarters in the United States). There are two key points to understand about inversions. First, the fault is with the tax code. Second, the companies that redomicile still pay tax to the IRS on their U.S.-source income.

Deferral

As noted above, American companies have some ability to delay the extra layer of tax that the U.S. worldwide tax system imposes on foreign-source income. To postpone the tax, companies must keep the money overseas, which presumably is not good for the U.S. economy. There are three competing solutions for this problem. First, a stop-gap measure would give companies a "repatriation holiday," meaning a temporarily lower tax rate on foreign-source income returned to America. Second, Congress could eliminate deferral and impose unlimited and immediate worldwide taxation. That solution would further undermine American companies competing against foreign firms for overseas market share, but it is true that U.S. companies would no longer have an incentive to keep any remaining profits overseas (though they would have a much bigger incentive to redomicile elsewhere). The third option is to join almost every nation and simply institute a territorial tax system. In that case, American companies would pay whatever taxes are due to foreign governments in the nations where they earn income, but there would be no second layer of tax on that income owed to the IRS. In a territorial tax system, there would be no artificial barrier to returning income to the United States.

Foreign Account Tax Compliance Act

The Foreign Account Tax Compliance Act is a sledgehammer in search of a fly. It has disrupted global commerce, yet it isn't even projected to

collect $1 billion annually. (To the degree that Americans were protecting money overseas, that option became very difficult with the imposition of numerous tax information exchange agreements in the past decade.) But the act does have real effects. It greatly disadvantages overseas Americans, who have a hard time finding banking services: foreign financial institutions fear a 30 percent withholding tax and exclusion from U.S. markets if U.S. clients get into any sort of dispute with the IRS. A sensible approach would be to repeal the entire law since it violates the sovereignty of other nations. An incremental approach would be to waive the law for nations that have tax information exchange agreements with the United States.

U.S. Funding for the Organization for Economic Cooperation and Development

The Paris-based OECD began as an innocuous international bureaucracy that compiled statistics and offered noncontroversial ideas to expand economic growth. In recent decades, however, the organization has embraced a statist agenda to promote larger government, including an anti-tax competition project designed to prop up uncompetitive welfare states. Even when it didn't interfere with policy, subsidies for the OECD were of questionable value. Now that the bureaucracy is a vehicle to promote statism, sending American tax collars to finance this organization is both wasteful and harmful.

Proposal to Make American Banks Help Enforce Foreign Tax Law

The Obama administration has asked Congress to modify tax laws to require U.S.-based financial institutions to collect and share information on foreigners who make indirect investments (purchasing stocks and bonds, for instance) in the American economy. Hopefully the Trump Administration will drop this proposal. Regardless, Congress should preserve existing law.

OECD Multilateral Convention

The Obama administration has signed a Protocol Amending the Convention on Mutual Administrative Assistance in Tax Matters. That may sound innocuous, but it actually represents a radical departure from existing law. It would give the White House authority to engage in promiscuous collection and sharing of sensitive financial information with dozens of nations—including many countries that have questionable records regard-

ing data integrity, human rights abuses, industrial espionage, and hostility to American interests. The Senate Foreign Relations Committee has approved the pact; but, fortunately, the agreement is subject to a "hold" by a couple of senators. Thus, it is very unlikely the agreement will go before the full Senate for ratification anytime soon. The protocol represents bad tax policy and should not be approved.

Conclusion

Our political system encourages elected officials to overpromise, overtax, and overspend. Fortunately, tax competition is an external constraint that discourages destructive tax policies. But if high-tax nations and international bureaucracies succeed in their campaign against low-tax jurisdictions, it's quite likely that nations will go back to the confiscatory tax rates that did so much damage to global growth in the 1970s.

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—Prepared by Daniel J. Mitchell

Health Care

35. Health Care Regulation

State governments should

- eliminate licensing of medical professionals or, as a preliminary step, recognize licenses issued by other states;
- eliminate "corporate practice of medicine" and "certificate of need" laws; and
- direct courts to enforce private contracts in which patients and providers agree upon alternative medical malpractice liability rules.

Congress should

- eliminate states' ability to use licensing laws as a barrier to entry by medical professionals licensed by other states;
- eliminate the U.S. Food and Drug Administration or, at a minimum, eliminate the FDA's authority to regulate drug efficacy, and allow other entities to certify safety and efficacy; and
- reject federal medical malpractice reforms.

By any measure, the United States spends more on medical care than any other nation. Health expenditures exceeded $10,000 per person in 2016, for a total of $3.6 trillion. Health care accounts for more than 18 percent of the U.S. economy. The problem with U.S. health care is not how much Americans spend, however. The problem is how little they get in return.

The U.S. health care sector has produced countless innovations that make health care better, more affordable, and more secure. These and further innovations should be exploding across the U.S. health care sector—making primary care more affordable for vulnerable patients such

as low-income single mothers and their children, making health insurance more secure for patients with expensive illnesses, and driving high-cost and low-quality providers and insurers out of business. Instead, Americans are suffering under a ridiculously cruel system of high and hidden costs, low-quality and inconvenient care, and shaky health insurance—because government protects high-cost, low-quality providers who would never survive in a market system.

Health care is a special area of the economy, where the right policies can save lives and the wrong policies can do extraordinary and irreversible harm. This chapter provides an introduction to the successes and failures of the U.S. health care sector. It and subsequent chapters then offer reforms that state and federal officials must enact to make health care work for all Americans, particularly the most vulnerable.

Government Control, Government Failure

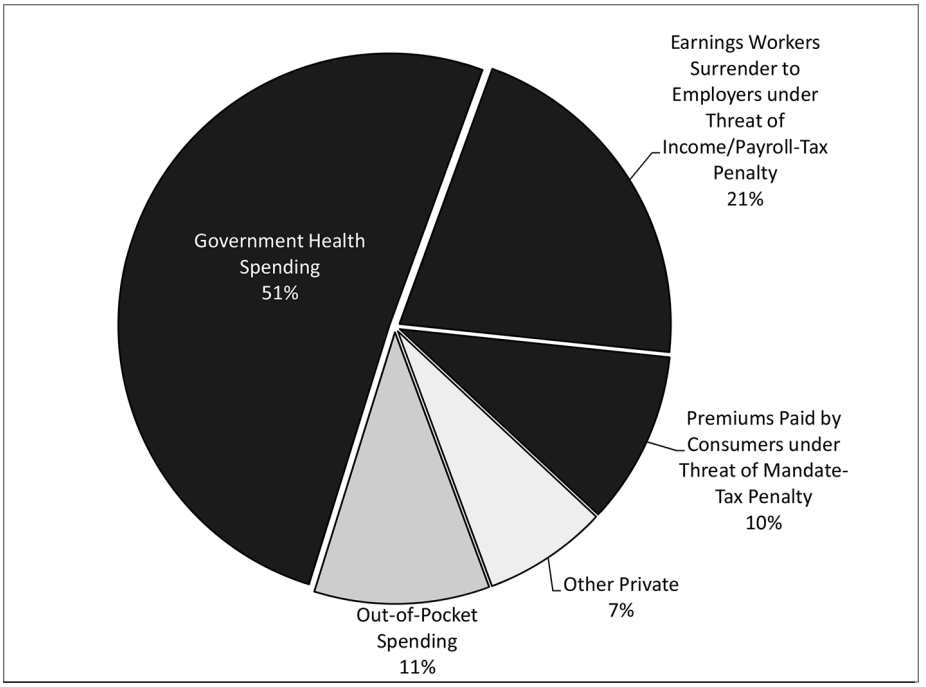
Contrary to popular belief, the U.S. health care sector is no more a free market than other nations' health systems. In the United States, government directly or indirectly controls more than 80 percent of health spending (Figure 35.1). It controls 51 percent ($1.7 billion in 2016) directly by taxing that money away from the people who earned it. It controls another 21 percent ($707 billion) by penalizing workers unless they surrender control over those earnings to their employers and let their employers choose their health plans. Government effectively controls the 10 percent of U.S. health spending that consumers pay toward private health insurance premiums ($345 billion) by penalizing consumers if they don't purchase a government-designed health plan. At best, consumers control just 10 percent ($350 billion) of U.S. health spending. Yet even that is an overestimate, since patients spend much of this money under terms dictated by government and employers.

Government further dictates what goods and services consumers may purchase, who may provide them, and what the prices will be. These interventions have reduced the quality of care, increased its cost, and made health insurance less secure.

Government Failure: An Epidemic of Low-Quality Care

The United States produces more new medical treatments and diagnostic tools than any other nation. Those innovations go on to improve health outcomes around the world. Open-ended health care subsidies and

Figure 35.1
Government Control of Spending on Health Care


Earnings Workers Surrender to Employers under Threat of Income/Payroll-Tax Penalty 21%
Government Health Spending 51%
Premiums Paid by Consumers under Threat of Mandate-Tax Penalty 10%
Other Private 7%
Out-of-Pocket Spending 11%

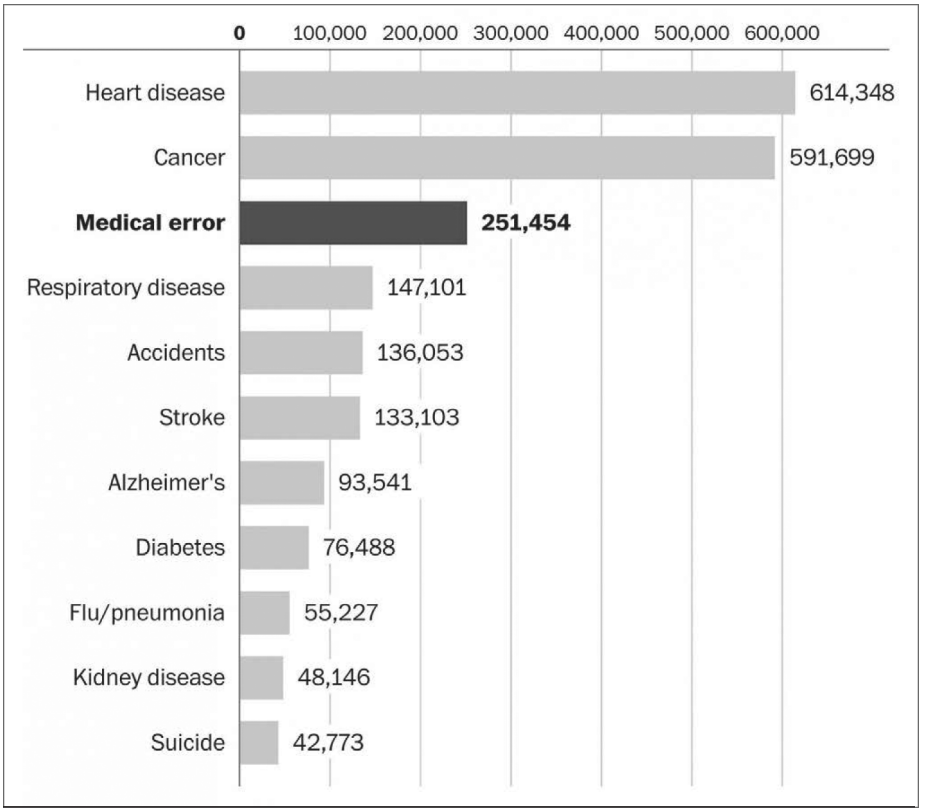
SOURCE: U.S. Centers for Medicare & Medicaid Services, Table 16—National Health Expenditures by Type of Sponsor (2016), https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/Downloads/Proj2015Tables.zip.

other government policies may play a role in this success. Even so, Americans suffer from an epidemic of low-quality care.

Researchers at Johns Hopkins University estimate that preventable medical errors cause 250,000 deaths annually, or roughly 1 out of every 10 deaths in the United States (Figure 35.2). That means preventable medical errors are the third-leading cause of death, after heart disease and cancer, and the cause of far more annual deaths than firearms (34,000) or a lack of health insurance (45,000 under the highest estimates).

Other examples demonstrate the poor quality of U.S. health care as well. For instance, researchers estimate that fewer than half of all medical interventions have reliable evidence demonstrating their effectiveness. Some estimate the share to be as low as 15 percent. Another example is from the U.S. Food and Drug Administration (FDA): the agency prevents terminally ill patients who have exhausted all approved therapies from accessing promising new treatments. In addition, the health care sector is

Figure 35.2
Causes of Death in the United States



SOURCE: Washington Post, https://www.washingtonpost.com/news/to-your-health/wp/2016/05/03/researchers-medical-errors-now-third-leading-cause-of-death-in-united-states/, based on data from National Center for Health Statistics and British Medical Journal.

behind other sectors in providing basic conveniences available in other sectors, like electronic scheduling, records, and communications.

Government Failure: Health Care Costs

Health care prices are high and continue to climb faster than incomes or the overall economy. A typical family health insurance plan, for example, costs $18,142—nearly a third of median family income ($56,516). Prices for medical services are unnecessarily high and opaque as well.

Countless government interventions increase medical prices and wasteful health care spending. Clinician licensing laws, the tax preference for employer-sponsored insurance, and government health care programs like

Medicare, Medicaid, and the State Children's Health Insurance Program all discourage patients from scrutinizing the costs and benefits of the services they receive, encourage providers to raise prices, encourage providers to deliver unnecessary services, and discourage transparent pricing.

On average, only 10 cents out of every dollar Americans spend on health care comes directly from the patient. Patients thus have little to no incentive to scrutinize whether the care they receive is worth the cost, or to demand lower prices. The result is health care prices that are higher than they would be in a market system and unnecessary services that account for an estimated one-third of total spending.

Government Failure: Insecure Access

Thanks to various government interventions, Americans routinely lose their health insurance for no good reason. Americans can lose coverage when they quit their jobs, get laid off, get fired, or become too sick to work; when their employer goes out of business, stops offering health benefits, switches health plans, or changes how much it pays for their benefits; when they divorce or a spouse dies; when they turn 19, or 26, or 65; when they become disabled; when they get arrested; when their income falls, or when their income *rises*; when their insurer offers coverage attractive to the sick; and when courts or elections reduce or end the taxpayer subsidies propping up their plan. Compounding the insecurity, Americans can lose access to their doctors and other providers because they lose their health plan, because government regulations punish insurers who offer comprehensive coverage, and when courts or elections intervene.

Even when Americans maintain consistent coverage, government erodes their access to care. With the implementation of the Affordable Care Act, the federal government now imposes "community rating" price controls on *every* health insurance plan in the United States. Community rating forces insurers to offer narrower provider networks and less coverage by punishing carriers who provide attractive coverage to the sick. Government literally creates a race to the bottom in health insurance.

A Market System: Better, More Affordable, More Secure Health Care

It does not have to be this way. Though far from a free market, the U.S. health care sector provides evidence that a market system can deliver better, more affordable, and more secure health care than alternative

systems. In corners of the U.S. health care sector where market forces have had room to breathe, they have produced remarkable innovations that protect the most vulnerable patients. These innovations save lives, reduce the burden of disease, get the right medicine to the right patient, reduce medical errors, and make health care easier.

Market Innovation: Prepaid Group Plans

Markets have developed innovative health plans that solve seemingly intractable problems. Unlike most health insurance, prepaid group health plans like Kaiser Permanente and Group Health Cooperative excel on many dimensions of quality where American health care suffers. They provide coordinated care with a single point of payment and accountability. They operate under incentives that encourage them to conduct comparative-effectiveness research and to use that research to guide clinical decisionmaking. They use medical teams to coordinate care. They encourage providers to make medical care safer by making the providers bear the financial costs of medical errors. They offer conveniences like electronic communications, scheduling, and medical records that are ubiquitous in other consumer industries. They even have the capacity to certify and monitor the safety and efficacy of drugs and medical devices in a way that respects the right of patients to choose their own course of treatment.

Integrated, prepaid group plans make health insurance and medical care more affordable. They create incentives to avoid wasteful and harmful care. They also make greater use of midlevel clinicians (e.g., nurse practitioners and physician assistants), who can deliver many services at a lower cost than physicians.

Market Innovation: Affordable Primary Care

Integrated health systems are not the only way market innovations reduce the cost of health care. Innovations in laser-eye surgery, for example, have caused prices to fall even as the quality of those services improves. Other examples include retail clinics, such as CVS's MinuteClinic, that make greater use of nurse practitioners and other midlevel clinicians—much like prepaid group plans—thus reducing prices for primary care visits by an estimated 30 percent.

The growth of ambulatory surgical centers and specialty hospitals provides more evidence that innovations are driving the cost of those services below the prices Medicare sets. Conversely, their growth means Medicare

is keeping prices for those services higher than they would be in a market system.

Market Innovation: Reverse Deductibles

Markets have developed insurance features that drive down the prices of common procedures by thousands or even tens of thousands of dollars. One such innovation in insurance design, called "reverse deductibles," makes patients more cost conscious. With reverse deductibles, insurers offer to pay health care providers a fixed amount per procedure, leaving their enrollees to pay 100 percent of the cost of the service above the fixed amount. When consumers face 100 percent of the marginal cost of services, they are much more likely to demand lower prices and switch to lower-cost providers.

In California, reverse deductibles caused prices for colonoscopies to fall by an average of 21 percent, or $360; for knee arthroscopy, more than $1,000 (18 percent); for shoulder arthroscopy, $1,336 (17 percent); and for hip and knee replacements, an average of $9,000 (26 percent). At hospitals that had been charging the most, they caused joint-replacement prices to fall by $16,000 (37 percent).

Market Innovation: Secure Health Insurance

Markets have developed innovative health-insurance products that make access to care more secure and save consumers potentially thousands of dollars. Voluntary health insurance is itself a market innovation. It harnesses the self-interest of policyholders and carriers to provide a sustainable system of subsidies to patients with expensive conditions. After that, markets kept innovating, offering greater protections to the sick and vulnerable.

The federal government's tax preference for employer-sponsored insurance diverts more than 80 percent of Americans with private insurance into employer-sponsored plans, where sick patients can see their premiums skyrocket if they divorce or leave their jobs. By contrast, the individual market that covers the remaining consumers developed protections such as "renewal guarantees" that allow patients with expensive conditions like diabetes, heart disease, or cancer to keep purchasing insurance at standard rates. Guaranteed-renewal health insurance swept the market years before the federal government required that all individual-market policies carry this feature.

Markets developed a further innovation known as "preexisting conditions insurance." This revolutionary product allows *uninsured* patients who develop expensive conditions to purchase health insurance at standard rates. Premiums for preexisting conditions insurance cost one-*fifth* the premium for the underlying health insurance policy. That's an 80 percent discount that would save the typical enrollee thousands of dollars. In 2008 and 2009, insurance regulators approved this product for sale in 25 states.

When Congress passed the Patient Protection and Affordable Care Act (ACA) of 2010, markets were close to offering health insurance products with a total-satisfaction guarantee that frees sick patients to fire their insurance companies and choose from other carriers who would compete for their business. The ACA destroyed guaranteed-renewal insurance, preexisting conditions insurance, and any further health insurance innovations.

Government Regulations Cost Lives

The government has kept these and other innovations from making health care better and more affordable for the most vulnerable patients. One example is integrated, prepaid group plans, which markets developed more than 70 years ago. The government has been blocking them—and the cost and quality improvements they offer—for even longer by way of almost countless interventions. Many states enacted laws directly prohibiting prepaid group plans. More broadly, government licensing of clinicians and insurers inhibits prepaid group plans.

Government harms consumers by tilting the playing field in favor of certain ways of organizing and financing health care. The federal government's tax preference for employer-sponsored health insurance and government entitlement programs steer providers and patients away from prepaid group plans and toward fee-for-service payment and nonintegrated providers. Government policies not only inhibit prepaid group plans, which create incentives to reduce medical errors, but Medicare, Medicaid, and the tax preference for employer-sponsored health insurance literally *punish* providers who save lives by reducing medical errors. These interventions mandate or encourage fee-for-service payment systems where providers receive payment both for the medical error that injures the patient *and* for the follow-up care to treat that injury. Such payment systems pay providers *less* when they invest resources in preventing medical errors. In addition, the federal government grants itself a monopoly over certification of the safety and efficacy of new drugs and devices, which denies prepaid

group plans yet another competitive advantage. Even where such plans have broken through these barriers, mostly on the West Coast, consumers are still not free to choose them. Federal and state tax laws penalize workers who choose health plans other than those their employer offers.

Day after day, Americans suffer the consequences of a century of mounting government failures. American health care is worse, more dangerous, more expensive, and less secure than a market system would deliver. Helping the most vulnerable patients requires more than repealing "Obamacare." It requires repealing *all* the barriers government places in the way of better, more affordable, more secure health care. It requires replacing America's dysfunctional government-run health care system with a market system.

Making health care better, more affordable, and more secure requires policymakers to do two things. First, they must return control over the $3.6 trillion America spends on health care to the patients that sector exists to serve—and eventually, leave that money with the workers who earned it. Like all government subsidies and tax preferences, those that separate Americans from their health care dollars inhibit innovation and create wasteful incentives. Second, policymakers must remove regulatory barriers to innovations that could bring better, more secure health care within reach of the most vulnerable patients.

Eliminate Government Licensing of Medical Professionals

Markets make medical care more affordable in large part by allowing less-trained clinicians, such as nurse practitioners and physician assistants, to perform tasks that were once performed only by highly trained physicians, whose services are more expensive. As Harvard Business School professor Clayton Christensen and his colleagues explain, "Many of the most powerful innovations that disrupted other industries did so by enabling a larger population of less-skilled people to do in a more convenient, less-expensive setting things that historically could be performed only by expensive specialists in centralized, inconvenient locations." State licensing of clinicians inhibits that market process.

To practice medicine in a state, physicians, nurse practitioners, physician assistants, and other clinicians must obtain a license from that state. Each state specifies the minimum requirements for each type of license and the tasks each license allows clinicians to perform. That list of tasks is called the clinician's "scope of practice."

Somewhat counterintuitively, groups representing various types of clinicians are constantly lobbying state governments to make these regulations *more* restrictive, by increasing the minimum requirements to obtain a given license or by limiting scopes of practice. The stated purpose is always to increase the quality of care. But the evidence does not support such claims. For example, when physician groups argue to restrict the scope of practice of nurse practitioners, they argue that a broader scope of practice would threaten patient safety. Yet study after study has shown midlevel clinicians provide a level of quality equal to that of physicians performing the same services. As the American Medical Association, the nation's largest lobbying group representing physicians, grudgingly admitted:

> More than 50 journal articles and reports comparing physician and nonphysician services have been reviewed. . . . These studies almost uniformly conclude that in the particular instances studied, a nonphysician clinician in defined circumstances can provide an acceptable level of care.

Moreover, licensing does little to discipline clinicians who actually harm patients. A study by the consumer watchdog Public Citizen found that between 1990 and 2005, "only 33.26 percent of doctors who made 10 or more malpractice payments were disciplined by their state board—meaning two-thirds of doctors in this group of egregious repeat offenders were not disciplined at all."

A more plausible explanation than concern for patient welfare is that physicians are trying to protect their incomes. For many services, nurse practitioners and other midlevel clinicians are substitutes for physicians and provide those services at a much lower cost. As noted above, a primary-care visit can cost 30 percent less at a nurse-practitioner-staffed retail clinic than at a physician's office. When state governments restrict the scopes of practice of midlevel clinicians, or require them to work under a physician's supervision, it increases demand for physicians and increases physician incomes.

Licensing also enables midlevel clinicians to do the same. Nurse practitioners, for example, compete not only with physicians, but also with physician assistants, registered nurses, and other nurse practitioners. As a result, established nurse practitioners often lobby state governments to restrict entry into their profession (e.g., by imposing greater education requirements on new nurse practitioners) and to restrict the supply of substitutes for nurse practitioners (e.g., by imposing narrower scopes of practice on physician assistants and registered nurses). Each type of regula-

tion increases incomes for existing nurse practitioners. Unfortunately, they also reduce the quality and increase the cost of medical care.

From a static perspective, licensing may do nothing to improve the quality of health care patients receive. Economists generally agree that although licensing increases the quality of medical services actually delivered, it also reduces the quantity of services delivered. But clinician licensing may actually be reducing the quality of care by inhibiting higher-quality forms of health care delivery. As noted earlier, prepaid group plans face unique incentives to make medical care and health insurance more affordable by making greater use of midlevel clinicians. By preventing midlevel clinicians from providing services they are competent to perform, licensing deprives such plans of a key competitive advantage. Licensing further inhibits such plans from spreading to additional states by requiring them to develop different work flows that conform to each state's ever-changing scope-of-practice rules for midlevel clinicians. Physicians have consciously used licensing to block competition from integrated delivery systems and prepaid health plans, because such delivery systems allow physicians less autonomy and are generally less remunerative.

Reform: Repeal Medical Licensing

Mere tinkering cannot fix the problems inherent in medical licensing. Whether the licensing authority is a legislature or regulatory agency—state or federal—there is no way to insulate it from influence by those whose incomes hang in the balance. Even if there were no threat of the regulated professions capturing the agency's power and enriching themselves at the expense of consumers, government is inherently unable to strike the proper balance between access and safety for millions of patients across billions of medical encounters. Such an authority would inevitably restrict access to care and block innovations that make medicine better, more affordable, and more secure. Medical licensing adds little if anything to the protections that medical malpractice liability and market forces already offer patients. State governments should eliminate it.

Many things would not change. Hospitals, health plans, and other organizations would continue to rely on board certification, private credentialing organizations, and their own internal processes to evaluate the competence of clinicians. Courts would continue to hold health care organizations and individual clinicians accountable for harm caused by negligence.

What would change is that providers would seek innovative ways to use midlevel clinicians to bring quality care within reach of more low-income Americans. Demand for private credentialing and the desire to protect brand names and reputations would do even more to safeguard patients from incompetent providers. Greater competition between different delivery and payment systems would drive the medical marketplace toward providing better health care to more Americans at a much lower cost.

Interim Reform: Stop Licensing from Blocking Interstate Commerce

If it is politically infeasible to eliminate medical licensing, policymakers can stop licensing laws from acting as a barrier to entry by clinicians licensed by other states. States should enact "good Samaritan" laws like those enacted in Tennessee, Illinois, Connecticut, and Missouri. Volunteer groups such as Remote Area Medical have had to turn away patients or cancel free clinics in California, Florida, and Georgia because those states' licensing laws did not allow clinicians licensed by other states to give away free care. "Before Georgia told us to stop," said Remote Area Medical founder Stan Brock, "we used to go down to southern Georgia and work with the Lions Club there treating patients." Missouri finally changed its laws after they prevented visiting optometrists from giving away free eyeglasses to residents devastated by a tornado that struck Joplin, Missouri. Visiting clinicians would still be liable for malpractice under the laws of the patient's state, or the contractual liability rules the patient and clinicians agree to honor (see below).

Licensing laws also create a barrier to interstate "telemedicine." In effect, they deny patients access to top specialists around the country and force patients to settle for whatever specialists happen to be licensed in their state. States can give rural and other patients access to top specialists by recognizing the licenses of telemedicine providers licensed by other states, or by redefining the location of care from the location of the patient to the location of the provider, where the provider already holds a license.

States could use such laws as a step toward recognizing all clinician licenses issued by other states. Congress could also use its power under the Commerce Clause to require states to recognize medical licenses issued by other states or, in a more narrow fashion, to recognize the licenses of clinicians providing charitable care or to redefine the location of care to be that of the clinician.

Medical Facilities

Another way markets might make medical care better, cheaper, and safer is through rigorous competition among medical facilities, including retail and other clinics, physician offices, urgent care clinics, ambulatory surgical centers, specialty hospitals, and general hospitals. State laws that require government approval of new medical facilities are a leading barrier to competition between medical facilities.

Many states impose laws requiring hospitals, nursing homes, and even physician offices to obtain a "certificate of need" (CON) from a state planning agency before opening a new facility or investing in new equipment. The rationale is that by restraining the supply of hospital beds, the government could restrain medical spending. In 1976, the federal government mandated CON planning nationwide.

CON laws failed to slow the growth of medical spending. In a survey of the empirical literature on CON laws, health economist Michael Morrisey writes that those studies "find virtually no cost-containment effects. . . . If anything, CON programs tended to increase costs." The failure of CON laws to achieve their stated aims led the federal government to lift its CON-planning mandate in 1987 and led many states to eliminate their laws also. Yet other states have maintained and even expanded their CON requirements.

Nor do they appear to have increased the quality of care. Examining cost and outcomes data for coronary artery bypass grafts, economists Vivian Ho and Meei-Hsiang Ku-Goto found, "CON regulations . . . may not be justified in terms of either improving quality or controlling cost growth." Physician-economist Daniel Polsky and colleagues found laws imposing CON on home-health agencies have "negligible" effects on quality or costs.

Incumbent-Veto Laws

Perhaps because CON laws have done nothing to contain spending, they have been a boon for incumbent health care providers. CON laws protect existing health care facilities from competition. Morrisey explains:

> A reasonably large body of evidence suggests that CON has been used to the benefit of existing hospitals. Prices and costs were higher in the presence of CON, investor-owned hospitals were less likely to enter the market, multihospital systems were less likely to be formed, and hospitals were less likely to be managed under for-profit contract. . . . The continued existence of CON and, indeed, its reintroduction and expansion despite overwhelm-

> ing evidence of its ineffectiveness as a cost-control device suggest that something other than the public interest is being sought. The provider self-interest view is worthy of examination.

Indeed, when new entrants apply for certificates of need, incumbent hospitals and other providers object the loudest. Law professor Sallyanne Payton and physician Rhoda M. Powsner explain that although the stated rationale of CON laws is to reduce health care spending, this claim "has diverted attention from the actual economic and political imperatives that led to and presently sustain certificate-of-need regulation. To attribute CON legislation to [cost-reduction] is to mistake a convenient theoretical justification for an actual motivation."

Reform: Repeal Incumbent-Veto Laws

CON laws increase health care costs without improving quality. They deny patients the benefits of new forms of health care delivery. There is no justification for them, and no place in a market economy for Soviet-style economic planning. States should eliminate CON laws immediately. State officials concerned about runaway health expenditures should reduce or eliminate the government subsidies that fuel such spending. (See Chapters 4 and 39.)

Pharmaceutical Regulation

In response to drug-related poisonings that killed over 100 children, Congress enacted the Food, Drugs, and Cosmetics Act of 1938. The act requires pharmaceutical manufacturers to demonstrate to the federal government that their products are safe. Originally, if the federal government did not reject the application within 180 days, the firm could proceed to market its product.

Another drug-related tragedy occurred when pregnant women taking the tranquilizer thalidomide gave birth to children with severe deformities. Thalidomide victims numbered over 10,000 worldwide. Relatively few were in the United States, as the FDA had not yet approved thalidomide for marketing. Congress nevertheless responded to this tragedy by enacting the 1962 amendments to the Food, Drugs, and Cosmetics Act. Since then, firms have had to prove to the FDA's satisfaction that their products are efficacious for the indication for which approval is sought and to obtain an affirmative approval from the FDA before marketing a new drug. Congress subsequently imposed similar regulations on new medical devices.

Table 35.1
FDA's Information Problem

FDA Decision	Helpful Drug	Harmful Drug
Approve	Patients benefit.	Patients suffer. Patients and the public *can* trace injury to FDA officials.
Delay/reject	Patients suffer. Patients and the public *cannot* trace injury to FDA officials.	Patients benefit.

NOTE: FDA - Food and Drug Administration.

You Can't Fix the FDA

The FDA faces an inherent information problem that inevitably leads to unnecessary patient suffering and death. Massachusetts Institute of Technology economist Ernst Berndt and colleagues describe the fundamental tension confronting the FDA or any organization certifying the safety and effectiveness of new products: "A central tradeoff facing the FDA involves balancing its two goals—protecting public health by assuring the safety and efficacy of drugs, and advancing the public health by helping to secure and speed access to new innovations."

There are two ways the FDA helps patients, and two ways it can harm them. It helps patients when it approves beneficial drugs and blocks harmful drugs. It harms patients when it approves harmful drugs (a "Type I error") and delays or rejects the approval of beneficial drugs (a "Type II error"). The tradeoff between Type I and Type II errors—that is, between the number of harmful drugs the FDA approves and the number of beneficial drugs it delays or rejects—is unavoidable. Reducing the number of harmful drugs approved (Type I errors) requires higher standards of evidence, more testing, more time, and more expense—all of which harm other patients, because those requirements necessarily increase the number of beneficial drugs that the FDA delays or rejects, or that drug manufacturers never develop (Type II errors). Conversely, reducing the number of beneficial drugs delayed or rejected (Type II errors) requires lowering those barriers to market entry, which inevitably leads to the approval of more harmful drugs (Type I errors).

Both Type I and Type II errors can cause suffering and death. As Table 35.1 illustrates, however, there is a very important difference between the two from the FDA's perspective. The political system penalizes FDA officials when a patient dies from a harmful drug the officials approved, but it far less often penalizes them when a patient dies because they delayed or blocked a beneficial drug.

- Type I errors bring swift and certain retribution down on agency officials because the victims are easily identifiable. When an FDA-approved drug injures or kills patients (Type I error), patients and the public can trace those injuries to the FDA's decision. The victims, their loved ones, the media, and Congress can discipline FDA officials for approving a harmful product. FDA officials know Type I errors lead to congressional hearings, public disgrace, and possibly even the end of their careers.
- In contrast, FDA officials typically face no consequences for Type II errors. Delaying or blocking beneficial drugs harms patients no less than approving unsafe drugs. But victims of Type II errors are much harder to identify, because it appears that the disease, not the FDA, killed them. Typically, neither the victims, nor their loved ones, nor FDA officials can identify which patients an unapproved but beneficial drug might have helped. The patients and their families may never have heard of the drug. Indeed, the high cost of winning FDA approval can deter companies from even developing new, potentially beneficial, drugs. Since it is typically impossible to trace the suffering and death of these patients to the actions of FDA officials, it is impossible to hold those officials accountable for this type of harm.

This fundamental information asymmetry means the political system can *only* discipline FDA officials when their decisions cause patients to suffer or die from Type I errors; it *cannot* discipline FDA officials when their decisions cause patients to suffer and die from Type II errors. Dr. Henry Miller, a former FDA official, describes how this information asymmetry affects the decisions of FDA officials:

> In the early 1980s, when I headed the team at the FDA that was reviewing the [new drug application] for recombinant human insulin, the first drug made with gene-splicing techniques, we were ready to recommend approval a mere four months after the application was submitted (at a time when the average time for [new drug application] review was more than two and a half years). . . . My supervisor refused to sign off on the approval—even though he agreed that the data provided compelling evidence of the drug's

> safety and effectiveness. "If anything goes wrong," he argued, "think how bad it will look that we approved the drug so quickly.". . . The supervisor was more concerned with not looking bad in case of an unforeseen mishap than with getting an important new product to patients who needed it.

This information problem leads FDA officials to support policies that *increase* morbidity and mortality. Suppose FDA officials were considering a new regulation that would prevent an estimated 1,000 deaths by blocking harmful drugs but would slow down the approval of new drugs such that 10,000 patients would die while waiting for life-extending drugs that otherwise would have been approved. Such a regulation would result in 9,000 additional deaths. FDA officials would nevertheless approve and implement it. In a perverse way, that decision makes sense. If FDA officials do not adopt the regulation, Congress and the public will hold them accountable for letting 1,000 patients die. If they do adopt it, Congress and the public will not—*cannot*—hold them accountable for letting 10,000 people die.

Every effort to quantify the costs and benefits of FDA regulation supports the conclusion that the FDA values some lives more than others. Tulane University economist Mary K. Olson estimates that when additional revenue from user fees enabled the FDA to review drugs more quickly, the health benefits of quicker access to new drugs were roughly 12 times greater that the costs from additional adverse drug reactions. In other words, the FDA was inflicting 12 times as much harm on patients through Type II errors as it was sparing patients by avoiding Type I errors.

University of Chicago economist Tomas Philipson and colleagues found that quicker reviews brought significant health benefits, but "did not, in fact, have any effect on drug safety." This finding implies the FDA will inflict additional deaths due to Type II errors even if doing so produces *no* reduction in deaths due to Type I errors. (Indeed, despite such research, many in Congress have sought to give the FDA additional powers to reduce Type I errors.)

A Better Way of Certifying and Monitoring Drugs and Medical Devices

Little is to be gained from minor FDA reforms such as adjusting user fees. The FDA's information problem guarantees that the agency will always value some lives more than others and tolerate unnecessary suffering and death. Fortunately, there is a voluntary, market-based alternative that

does not suffer from the FDA's information problem and that respects the right of patients to make their own medical decisions.

Nobel prize–winning economist Gary Becker advocated eliminating the FDA's efficacy standard and returning the FDA to the *status quo ante* 1962, when the FDA had the power only to block drugs it believed to be unsafe. That would be worth doing. The evidence strongly suggests that eliminating the efficacy standard would reduce so much morbidity and mortality by reducing Type II errors that those gains would swamp the increase in Type I errors. The problem, of course, is the increase in Type I errors. So long as there exists a government agency whose purpose is to protect patients from harmful drugs, then agency officials, the public, and Congress will always respond to Type I errors by trying to increase the barriers to new drugs. If enough Type I errors subsequently occurred, then Congress would likely reinstate the efficacy standard, even if doing so would cost lives. Congress or the FDA could also eliminate any gains by increasing the amount of testing required to establish safety. Such will always be the incentives of politicians or a government agency charged with ensuring drug safety and efficacy.

Congress would do better to eliminate any role for the FDA in certifying the safety and efficacy of drugs. Economist Sam Peltzman argues that even the safety requirement delivers more harm than benefit. Another Nobel prize–winning economist, Milton Friedman, proposed eliminating the FDA entirely.

Eliminating the efficacy standard would increase patient demand for private certification of safety and efficacy, which currently exists only informally. (Economist J. Howard Beales III found that the *U.S. Pharmacopeia Drug Information* certified newly discovered uses of approved drugs—so-called "off-label uses"—an average of two and one-half years sooner than the FDA.) The threat of liability for harmful products would create powerful incentives for pharmaceutical manufacturers to conduct appropriate testing and seek private certification.

In a market system, health plans like Kaiser Permanente and Group Health Cooperative could provide safety and efficacy certification, which the FDA now monopolizes. Integrated, prepaid group plans are uniquely capable of performing these functions. Prepaid group plans already lead the industry in effectiveness research and the use of electronic medical records, which are essential to tracking accurately a drug's effects on patients. When the FDA wanted to determine whether the pain reliever Vioxx was causing heart attacks, the agency could not conduct that research itself. It turned to Kaiser Permanente of Northern and Southern California.

Prepaid group plans internalize the costs of wasteful and harmful care and would therefore face strong incentives not to approve unsafe or ineffective drugs. At the same time, different plans would cater to different risk preferences by applying different approval requirements. Each plan's reputation for quality (and ability to attract enrollees) would depend on the perceived value of its seal of approval.

Health plans like Kaiser Permanente and Group Health Cooperative could do the FDA's job better than the FDA. Congress prohibits the FDA from considering cost-effectiveness as a criterion for approval. In contrast, prepaid group plans face financial incentives to ensure that their enrollees receive maximum value for their money. They could condition their seal of approval on whether a drug provides benefits that are worth the cost. The FDA's ability to monitor a drug ends after approval. Prepaid group plans could continue to monitor safety and efficacy post-approval and could more quickly detect adverse drug reactions.

Perhaps most important, market-based certification would save more lives by striking a better balance between Type I and Type II errors. Unlike the FDA, private health plans could not block drugs from the market. Market-based certification respects the freedom of doctors and patients to make treatment decisions according to individual circumstances. It also provides them with information more quickly than government certification. Patients within or outside of such plans would rely on whichever plan's seal of approval fit their own risk preferences.

The first step toward reforming the regulation of drugs and medical devices may be to eliminate the barriers that Congress and state legislatures have erected to integrated, prepaid group plans. (See above, and Chapters 36, 37, and 38.) Concurrently, Congress could allow alternative ways of certifying the safety and efficacy of medical products by granting marketing approval to products approved by other countries' regulatory bodies. The next step would be to eliminate either the efficacy standard or the FDA entirely. Either would save lives, on balance, because patients would get quicker access to more beneficial new drugs. While patients would also have quicker access to harmful drugs, two factors make that unfortunate effect tolerable. First, more patients would benefit—more patients would live—thanks to greater innovation and quicker access to helpful drugs than would suffer as a result of harmful drugs. Second, eliminating either the efficacy standard or the FDA itself would lead to greater skepticism of new drugs by doctors and patients. Finally, innovations by prepaid group plans and others would more quickly detect and stop adverse drug reactions.

Medical Liability Reform

The right to sue health care providers for medical malpractice is an important tool for protecting patients from injury due to negligent care. Patients typically have little information about the quality of care. To the extent the medical malpractice "system" imposes the costs of negligent care on providers, it aligns the incentives of providers with those of patients.

Nevertheless, many people complain—with some justification—that the medical malpractice liability system in the United States performs poorly. Research suggests malpractice liability does little to discourage negligent care, that only a small fraction of patients injured by provider negligence actually recover damages from providers, and that many who do recover are not victims of negligence. Many specialists (neurosurgeons and obstetricians, to name two) report that they cannot afford the rising cost of medical liability insurance. Duke University professor Christopher Conover estimated that in 2002, the U.S. medical liability system cost Americans $81 billion more than it produced in benefits. Physicians and other providers—who have seen often-dramatic increases in malpractice insurance premiums—have intermittently declared the medical liability system to be in "crisis" for over 30 years.

This "crisis" has spawned numerous proposals to reform medical malpractice liability rules, including a nationwide cap on noneconomic damages similar to the $250,000 cap California imposes. Other proposals include legislative limits on contingency fees for plaintiffs' attorneys; "no-fault" compensation systems for medical injuries, such as the limited programs adopted in Florida and Virginia; alternative forms of dispute resolution, such as arbitration and special medical courts; the English rule of costs; and reform of the collateral source rule.

Each of these reforms would leave some patients better off—typically by reducing prices for medical care—at the cost of leaving other patients worse off. So-called "loser pays" reforms often reallocate the costs of frivolous lawsuits to the correct party. However, that rule deters less affluent patients from seeking legal redress for legitimate grievances. A cap on noneconomic damages would reduce health care costs for noninjured patients, but at the expense of leaving some injured patients with uncompensated losses. Limits on contingency fees would reduce costs for noninjured patients, but at the cost of denying compensation to injured patients whose cases plaintiffs' attorneys deem too expensive to pursue. Perhaps most important, any reduction in provider liability potentially jeopardizes

patient safety by reducing the incentives for providers to avoid negligent care.

Many Republicans want Congress to enact a nationwide set of limits on malpractice liability. As discussed in Chapter 15, the U.S. Constitution does not authorize Congress to impose substantive rules of tort law on the states. Though the federal government may enact technical procedural changes to tort law, state legislatures are the proper venue for correcting excesses in their civil justice systems. The fact that medical professionals can avoid states with inhospitable civil justice systems gives them significant leverage when advocating state-level medical liability reforms and gives states incentives to enact such reforms. Indeed, many states have.

Yet state-imposed medical malpractice reforms share two flaws with federally imposed rules. As noted earlier, imposing one set of limits on the right to sue for medical malpractice on all patients and providers will help some patients but hurt others. Codifying those rules makes removing harmful ones extremely difficult.

A more patient-friendly and liberty-enhancing approach would allow patients and providers to write their own medical malpractice reforms into legally enforceable contracts. For cases of ordinary negligence, patients could choose the level of protection they desire, rather than have a uniform level of protection (and the resulting price) imposed on them by the government. Providers could offer discounts to patients who agree to limits on compensation in the event of an injury. Patients who don't agree could pay the nondiscounted price or seek a better deal from another provider. Insurance companies could facilitate such contracts on behalf of their enrollees. Those companies would have strong incentives to ensure that such contracts provide adequate protection; otherwise, the insurers could face higher claims from injured patients who could not collect the full extent of their damages. Regular tort rules would continue to apply in cases where patients and providers did not contract around them, where patients were subject to duress, or where providers were guilty of intentional wrongdoing or reckless behavior.

Freedom of contract would make medical care more affordable to many low-income patients. It would also enhance quality competition. Providers who know they are less likely to injure patients could offer more expansive malpractice protections or equivalent malpractice protections at a lower cost. Low-quality providers would not be able to do the same and would face strong financial incentives to improve their processes of care.

Such contracts are not possible today because courts have invalidated them as "contracts of adhesion" or "against public policy." The refusal to

honor those contracts restricts the freedom of adults to make mutually beneficial exchanges that hurt no one else. It also increases the cost of providing medical care to the poor, which has undoubtedly reduced their access to care. To remedy this costly restriction on liberty, courts should abandon their current policy and enforce contractual limitations on the right to sue for medical malpractice. If courts refuse, state legislatures should require them to do so. Economist Richard Thaler and law professor Cass Sunstein write:

> In our view, state lawmakers should think seriously about increasing freedom of contract in the domain of medical malpractice, if only to see whether such experiments would reduce the cost of health care without decreasing its quality. Increasing contractual freedom won't solve the health care crisis. But it might well help—and in this domain every little bit of help counts.

As noted earlier, the medical malpractice system does a poor job of providing relief to injured patients, preventing frivolous lawsuits, or discouraging negligence. The remedies for these shortcomings are not obvious. A dynamic marketplace that allows parties to experiment with—and abandon—different malpractice rules is the quickest and surest way to find those solutions.

Conclusion

Sixty years ago, before Congress enacted the Affordable Care Act, State Children's Health Insurance Program, or even Medicare and Medicaid, Milton Friedman made a prediction—if the government stopped interfering in the market for medical care, markets would develop the very innovations that central planners are now struggling to create:

> Suppose that anyone had been free to practice medicine without restriction except for legal and financial responsibility for any harm done to others through fraud and negligence. I conjecture that the whole development of medicine would have been different. The present market for medical care, hampered as it has been, gives some hints of what the difference would have been. Group practice in conjunction with hospitals would have grown enormously. Instead of individual practice plus large institutional hospitals conducted by governments or eleemosynary institutions, there might have developed medical partnerships or corporations—medical teams. These would have provided central diagnostic and treatment facilities, including hospital facilities. Some presumably would have been prepaid, combining in one package present hospital insurance, health insurance, and group

> medical practice. Others would have charged separate fees for separate services. And of course, most might have used both methods of payment.
>
> These medical teams—department stores of medicine, if you will—would be intermediaries between the patients and the physician. Being long-lived and immobile, they would have a great interest in establishing a reputation for reliability and quality. For the same reason, consumers would get to know their reputation. They would have the specialized skill to judge the quality of physicians; indeed, they would be the agent of the consumer in doing so, as the department store is now for many a product. In addition, they could organize medical care efficiently, combining medical men of different degrees of skill and training, using technicians with limited training for tasks for which they were suited, and reserving highly skilled and competent specialists for the tasks they alone could perform. The reader can add further flourishes for himself, drawing in part, as I have done, on what now goes on at the leading medical clinics.

Since then, state and federal governments have unfortunately and dramatically increased government's footprint in the health care sector, making these innovations seem more elusive than ever. Reformers who want better health care for the most vulnerable patients should consider the reforms in this and subsequent chapters.

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—Prepared by Michael F. Cannon

36. Health Insurance Regulation

State legislators should

- eliminate licensing of health insurance or, as a preliminary step, recognize insurance products licensed by other states.

Congress should

- repeal the Patient Protection and Affordable Care Act;
- eliminate states' ability to use licensing laws as a barrier to trade with out-of-state insurers; and
- relinquish any role as an insurance regulator.

Every year, millions of Americans walk or are carried into hospitals. Many are ill. Others are injured. Some are in extreme pain. Some are close to death. Using the tools of modern medicine, doctors routinely heal their pain and save their lives.

No less marvelous is that for decades, millions of these and other patients had their medical bills paid, voluntarily, *by complete strangers*. The benefactors did not know the patients. They did not know their illnesses. They may not have practiced the same religion or even spoken the same language. Had they met the patients, they might not have even liked them. And yet, without anyone pressuring or forcing them to do so, these strangers repeatedly purchased lifesaving medical care for others. Indeed, they played a role every bit as important as the doctors and hospitals. By some marvel, this wonderful phenomenon occurred every day in the United States without central direction or compulsion.

That marvel is voluntary health insurance. When individuals choose to purchase health insurance, they agree to pay the medical expenses of those in the insurance pool who become sick or injured. They uphold that agreement by paying a periodic premium to an insurance company. To be sure, it is not compassion for others but self-interest that motivates

most insurance purchasers. Each wants to have her own medical bills paid when she is sick or injured. Yet that only makes voluntary health insurance markets all the more marvelous: it harnesses the self-interest of millions of strangers to produce an unquestionably compassionate result.

As discussed in Chapter 39, that sort of generosity invites opportunistic behavior. If somebody else is paying for all their medical care, some patients will consume more medical care than they need. (And why not? Those other people in the pool who bear the cost are just strangers.) Likewise, health care providers will try to sell those patients more medical care than they need. If individuals can tap this generosity whenever they choose, many will not contribute to the pool until they become sick. At that point, what they draw from the pool could well exceed their premium contributions. If enough people join the pool too late, then premiums will spiral out of control, and then no one will want to participate. For these reasons, members of the insurance pool hire someone to protect themselves and their generosity from opportunistic behavior. Those intermediaries are private health insurance carriers.

Health insurance companies prevent this unquestionably compassionate arrangement from unraveling. As intermediaries between members of the insurance pool, insurance carriers charge higher premiums to enrollees who purchase more extensive coverage because those members will draw more money from the pool. Charging more for more coverage also encourages people to purchase only the coverage they truly value. In addition, insurance companies require members to pay part of the cost of their own medical care. Deductibles, reverse deductibles, coinsurance, and copayments discourage wasteful medical care and help ensure that members aren't careless with other members' money. In many cases, they look over physicians' shoulders. Managed-care tools like capitated payments, preauthorization, and utilization review help ensure physicians are being careful with their members' money and health.

Risk-Based Premiums Protect Consumers

In a market system, insurance carriers further protect their members by charging higher premiums to new enrollees who have a higher risk of needing medical care and lower premiums to enrollees with a lower risk. If an individual waits until she is sick to join the pool, her premiums will therefore be much higher than if she joined while healthy. Risk-based premiums therefore both preserve the stability of the insurance pool and promote compassionate behavior. If individuals could wait until they got

sick to join the pool, few would contribute to the pool while healthy. In that event, premiums would climb until the pool collapsed. When insurers set premiums according to risk, they prevent individuals from taking advantage of the generosity of other members of the insurance pool. They are also promoting compassionate behavior. Risk-based premiums encourage individuals to contribute to the pool while they are still healthy and their premiums are low, so their premiums can help save the lives of strangers. Thanks to an innovation called "renewal guarantees," insurers don't increase members' premiums when they become ill.

Insurers compete to see who can best manage these features and provide members the protection they desire at the lowest possible premium. That competition is the market's way of navigating the Samaritan's dilemma, discussed in Chapter 39.

Do Health Insurance Markets Fail?

Critics lodge several complaints against voluntary insurance markets. They argue that unregulated insurance markets do not provide secure access to medical care. They claim that risk-based premiums are unfair. They say that insurance companies drop people when they get sick. They complain that markets will not provide health insurance to everyone. Finally, they argue that government must create compulsory pooling arrangements to correct these alleged market failures.

Evaluating the performance of unregulated health insurance markets is difficult. Since 2014, all health insurance in the United States has involved some form of compulsion. Even before then, the vast majority of Americans with health insurance obtained it through compulsory arrangements. For example:

- Nearly all seniors obtain health insurance from the government through the federal Medicare program (see Chapter 38).
- Even before the Patient Protection and Affordable Care Act (ACA) took effect in 2014, federal and state tax laws imposed large penalties on workers whose employers do not offer coverage or who turn down the health insurance their employer offers (see Chapter 37). As a result, more than 80 percent of Americans who have private health insurance get it through an employer. Since 2014, the ACA has threatened nearly all Americans with penalties if they do not purchase health insurance.
- Prior to the ACA, Congress already prohibited employer-based health plans from protecting their members by charging risk-based premiums.

Many states imposed such price controls (and other costly regulations) on the individual market. With the ACA, Congress has banned this consumer protection from all forms of insurance.

The evidence we have about how voluntary, unregulated health insurance markets perform comes from the individual market prior to the ACA. Even then, this market made for an imperfect test case. Numerous government interventions left the individual market with fewer consumers and higher administrative costs.

Markets Provide Secure Access to Health Care

Researchers examining these badly hampered markets nevertheless have found considerable evidence that unregulated markets provide consumers with reliable long-term protection from the cost of illness. University of Pennsylvania economist Mark Pauly and his colleagues found the following:

- "Actual premiums paid for individual insurance are much less than proportional to risk, and risk levels have a small effect on obtaining coverage."
- "Premiums do rise with risk, but the increase in premiums is only about 15 percent of the increase in risk. Premiums for individual insurance vary widely, but that variation is not very strongly related to the level of risk."
- "Guaranteed renewable" policies, which allow enrollees who develop expensive illnesses to keep purchasing coverage at standard premium rates, "appear to be effective in providing protection against reclassification risks in individual health insurance markets."
- The vast majority of insurance products (75 percent) provided guaranteed renewability *before* the federal government mandated it in 1996.
- Unregulated markets provide sick enrollees coverage that is more secure than employer-sponsored coverage. High-cost individuals who enroll in coverage through small employers are nearly twice as likely to end up uninsured as high-cost individuals with individual-market coverage.
- "On average, guaranteed renewability works in practice as it should in theory and provides a substantial amount of protection against high premiums to those high-risk individuals who bought insurance before their risk levels changed."

Similarly, RAND Corporation economist Susan Marquis and colleagues found that the individual market protects enrollees with expensive conditions and that risk-based premiums are not as harsh as critics imply:

- In the individual market, "a large number of people with health problems do obtain coverage."
- "We also find that there is substantial pooling in the individual market and that it increases over time because people who become sick can continue coverage without new underwriting."
- Regarding enrollees who purchase insurance and later become sick, "in practice they are not placed in a new underwriting class."
- "Purchasers derive value from having the range of choices that the individual market offers."
- "Our analysis confirms earlier studies' findings that there is considerable risk pooling in the individual market and that high risks are not charged premiums that fully reflect their higher risk."

Do Carriers Drop Coverage Because Enrollees Get Sick?

Critics counter that without regulation, insurance companies could and did cancel coverage, often retrospectively, when enrollees fell ill and began filing expensive claims. It is indeed true that insurance companies sometimes rescind coverage—often with good reason.

Another type of opportunistic behavior, in which individuals attempt to take advantage of other members of the insurance pool, is fraud. A person who waits until she is sick to purchase coverage, then lies to the insurance company about her need for medical care, is not contributing to the pool while she is healthy. She is only drawing from the pool when she is sick. She is therefore taking advantage of others in the pool. By only joining the pool once she is sick, she is also making the pool sicker on average. This makes health insurance less available to others by driving up its cost. Rescinding coverage from people who commit fraud is a consumer protection. Such rescissions make health insurance more widely available and protect members of the insurance pool from individuals who would take advantage of them.

Insurers could indeed rescind coverage for misrepresentations that were not fraudulent. Whether a misrepresentation was intentional and material, or just a clerical error, is often a judgment call, and there is no obvious place to strike the balance between protecting members of the insurance pool from fraud and forgiving those who made innocent mistakes on their

applications. A market system has ways of punishing insurers who are too aggressive with rescissions. Prior to the ACA, media scrutiny of rescissions led California insurers to reinstate coverage for many enrollees. Media scrutiny and insurers' concern for the reputation of their brand are market mechanisms. Insurers can also spell out rescission policies in insurance contracts, and victims of overzealous rescissions can take insurers to court. Each of these types of consumer protection can spur insurers to change their behavior.

Critics also allege insurers will cancel entire health plans to avoid covering enrollees with expensive conditions. Pauly and colleagues found that "although there are some anecdotes about individual insurers trying to avoid covering people who become high risk (for example, by canceling coverage for a whole class of purchasers), the data on actual premium risk relationships strongly suggest that such attempts to limit risk pooling are the exception rather than the rule." All told, free markets provide considerably better and more secure health coverage than critics suggest.

Should Markets Provide Universal Coverage?

Critics correctly note that voluntary insurance will not provide health insurance to everyone. Nor should it. Exclusions for preexisting conditions are essential for creating a stable system of subsidies for people who develop expensive conditions, and for reducing the number of people with preexisting conditions who lack secure coverage. Allowing exclusions for preexisting conditions does not preclude other options for subsidizing the needy, a topic discussed in Chapter 39.

Even when insurers can charge premiums that reflect risk, voluntary insurance pools often will decline to cover medical conditions that are known to exist at the time an individual applies for coverage. Exclusions for preexisting conditions do not indicate a lack of compassion by insurance companies or consumers. They are the market's way of telling us that *consumers* do not want to subsidize people with preexisting conditions *through insurance*.

If voluntary insurance pools offered coverage for preexisting conditions, few individuals would purchase insurance until they had an expensive medical condition, as already discussed. Insurance pools would unravel. Exclusions for preexisting conditions are therefore essential to preserve the stable system of subsidies that voluntary insurance pools create for those who develop expensive conditions. Exclusions for preexisting conditions also reduce the number of people with expensive illnesses who lack

coverage. They encourage individuals to purchase coverage before they develop an expensive condition, so that they will then have access to that stable system of subsidies if they develop such a condition.

That still leaves a problem. Risk-based premiums and rescissions for fraud encourage most people to purchase insurance before they become ill. Yet there will always be some people who either did not join a pool while they were still healthy or never had the opportunity because their high-cost condition has been with them since birth. Assuming they cannot afford medical care, these individuals require *subsidies*—not *insurance*. Insurance is merely one way—and in reality, a very expensive and ultimately harmful way—of subsidizing preexisting conditions. Insurance resembles a blank check. Charities and other compassionate people tend not to give blank checks to strangers. Strangers are difficult to monitor and (encouraged by their health care providers) may take more than they need. Other ways of subsidizing people with preexisting conditions include limited amounts of cash, vouchers, or in-kind subsidies from providers, private charities, or the government. Exclusions for preexisting conditions are the market's way of telling us that—relative to these alternatives—the added costs of subsidizing preexisting conditions through insurance far outweigh the added benefits.

Regulation Blocks Secure Health Insurance

The United States no longer has a voluntary health insurance market. As noted earlier, federal and state governments divert the vast majority of consumers into job-based insurance by penalizing them if they do not enroll in their employer's coverage. Federal and state governments also impose countless regulations on insurance markets. They restrict insurance pools' ability to limit or refuse coverage and to vary premiums according to risk. They dictate what coverage insurers must offer, limiting consumers' freedom to purchase only the coverage they wish. States limit the ability of insurers to negotiate price discounts from providers. Finally, states prohibit their residents from purchasing insurance from states with more consumer-friendly regulation.

The most disastrous health insurance regulations are requirements known as "guaranteed issue" and "community rating" that create a scheme of government price controls. Guaranteed-issue mandates attempt to *expand access to health insurance* for people with preexisting conditions by requiring insurers to offer coverage to all applicants. This regulation therefore allows people to take advantage of strangers by removing the insurance

pool's ability to protect itself from opportunistic behavior. It allows individuals to avoid contributing to an insurance pool until they have a high-cost condition, which is akin to letting drivers who cause an accident purchase retroactive auto insurance. Guaranteed-issue requirements leave insurance pools smaller and sicker, which puts upward pressure on premiums.

Insurance pools could still protect themselves somewhat by charging higher premiums to individuals who wait until they are sick to join the pool. But because many people with preexisting conditions cannot afford those risk-based premiums, and since the purpose of guaranteed-issue requirements is to give those individuals access to health insurance, the government also limits the extent to which insurance pools can price coverage according to risk.

In its purest form, community rating requires insurance pools to charge the same premium to all members, regardless of their health risk. The Patient Protection and Affordable Care Act imposes a guaranteed-issue requirement and community-rating price controls on the entire individual market. Insurers must charge all enrollees of a given age the same premium, regardless of health status. Insurers may charge their oldest enrollees no more than three times their youngest enrollees, even though the oldest enrollees typically cost six or seven times as much to insure.

Even before the ACA was enacted, several states and the federal government imposed various restrictions on the ability of insurance pools to deny coverage for or to vary premiums on the basis of preexisting conditions. In some states' individual markets, and in employment-based coverage, these requirements are even stricter than under the ACA.

Community-rating laws try to force insurance pools to *provide greater subsidies* to people with preexisting conditions. They do so by forcing healthy people to pay higher premiums than otherwise, so that less healthy people can pay lower premiums. Put differently, these laws prevent insurers from responsibly managing the relationships between members of a pool. When community rating requires insurers to charge healthy 18-year-olds the same premium as 50-year-olds with multiple chronic conditions, it encourages all parties to behave in ways that are harmful to the pool and to society:

- Individuals with preexisting conditions see their premiums fall, and therefore purchase more coverage. That increases claims made against the pool, which increases the community-rated premium.

- Healthy individuals see their premiums rise to subsidize sicker members of the pool, who are generally older and (ironically) tend to have higher incomes. Many drop out of the pool, safe in the knowledge that if they get sick, the government will require insurers to sell them coverage at the same premium they charge healthy people. Their departure makes the pool sicker on average, which further increases premiums. This causes additional healthy members to drop out of the pool. Economists and actuaries call this vicious cycle an "adverse selection death spiral." To prevent a death spiral, the ACA imposes an individual mandate that penalizes Americans if they do not purchase health insurance, and spends $1 trillion over 10 years to hide the full premium from consumers in the individual market.
- Fewer enrollees engage in healthy behaviors or avoid unhealthy behaviors, because doing so no longer reduces their health insurance premiums. This adversely affects health and increases claims and premiums.
- Community-rating price controls create a race to the bottom on quality. Since all enrollees must pay the same premium regardless of their expected claims, healthy members become a gold mine and sick enrollees become a liability. Any insurer who becomes known for providing the best coverage for the sick risks bankruptcy. Insurers therefore compete to provide coverage that is attractive to healthy individuals and unattractive to the sick. Insurers may also make enrollment difficult for sicker people, or curtail services that sick people value, hoping that sicker members will choose another carrier. Insurance-company greed cannot explain the race to the bottom. Community-rating price controls reward insurers for offering coverage that is unattractive to the sick if insurers do so unintentionally.
- Community rating requires even more regulation and government intervention. Supporters are aware of the perverse incentives that community-rating price controls create. In an attempt to prevent a race to the bottom, the ACA further regulates the content and marketing of health insurance plans. These requirements increase the cost of coverage and require consumers to buy coverage they do not want and may find morally objectionable (e.g., coverage for contraceptives). These provisions appear not to be working. Insurers participating in the ACA's health insurance "exchanges" have curtailed provider networks, increased cost sharing on specialty drugs, and taken other steps to avoid providing coverage attractive to the sick.

For all the damage they cause, guaranteed-issue and community-rating laws appear to offer little benefit in terms of expanding coverage to the sick. On the basis of their pre-ACA studies of unregulated markets and markets with community rating, Pauly and his colleagues reach the following conclusion:

> We find that regulation modestly tempers the (already-small) relationship of premium to risk, and leads to a slight increase in the *relative* probability that high-risk people will obtain individual coverage. However, we also find that the increase in overall premiums from community rating slightly reduces the total number of people buying insurance. All of the effects of regulation are quite small, though. We conjecture that the reason for the minimal impact is that guaranteed renewability already accomplishes a large part of effective risk averaging (without the regulatory burden), so additional regulation has little left to change.

Community Rating Blocks Innovative, Secure Coverage

Finally, guaranteed-issue and community-rating laws have destroyed innovative insurance products and prevent the development of further innovations that provide more secure coverage to people who develop expensive conditions. As previously noted, guaranteed-renewable health insurance is an innovation that allows consumers who develop expensive conditions to keep purchasing coverage at standard premiums. Insurers build up reserves to cover those costs. When Congress tried to solve the problem of preexisting conditions with the ACA's guaranteed-issue and community-rating provisions, it made guaranteed-renewable health insurance impossible. Blue Cross Blue Shield of North Carolina used its $156 million guaranteed-renewability reserve fund to issue all of its policyholders refunds averaging $725 each. Market forces had led insurers to set that money aside for the sick. The ACA led insurers to give it away to healthy people.

The ACA destroyed another innovative and promising insurance product that markets had just begun to introduce. In 2008 and 2009, insurance regulators in 25 states approved the sale of "preexisting conditions insurance." These products allow *uninsured* enrollees who develop expensive conditions to purchase health insurance at standard rates. UnitedHealthcare Group offered this revolutionary product for 20 percent of the cost of the underlying health insurance policy, a savings of thousands of dollars per year.

Like a renewal guarantee, preexisting conditions insurance protects consumers against the risk that their premiums will rise after they get an expensive, long-term medical condition. The ACA's community-rating price controls destroyed the market for these innovations by imposing a government-dictated approach to pooling those risks.

Finally, the ACA is preventing markets from developing further innovations. Two examples illustrate the possibilities. Law professors Tom Baker and Peter Siegelman explain how insurers could make health insurance more attractive to so-called "young invincibles," and thus induce them to purchase it voluntarily, by offering cash back to people who don't file claims. Economist John Cochrane explains how markets could offer health insurance with a total satisfaction guarantee: health insurance contracts could allow sick enrollees who grow dissatisfied with their coverage to fire their insurance company, receive a large cash payout, and then choose from among other carriers who would compete to cover rather than avoid them.

Markets can make health care more secure by protecting sick patients from the incentives insurers face to renege on their commitment to provide secure coverage. At the same time the ACA increases incentives for insurers to renege on those commitments, it blocks the market's ability to solve that problem and to make health care more secure for the sick.

State Regulations Harm Patients

States have enacted further health insurance regulations that harm patients. For example, more than half of states increase the cost of health insurance with "any-willing-provider" laws. Health insurers frequently negotiate discounts from providers. In exchange, those "preferred" providers receive a greater volume of business as insurers steer enrollees toward them. Any-willing-provider laws require insurers to offer the same payment levels and contract terms to any provider who agrees to those terms. "Any-willing-provider legislation removes the incentive to compete aggressively on a price basis," writes health economist Michael Morrisey. "No one has an incentive to offer much of a discount since discounts will result only in lower prices with little or no expanded volume." The result is that consumers pay more for medical care and for health insurance.

Like the federal government, all states increase the cost of health insurance by requiring consumers to purchase certain types of coverage, whether or not they want it. Many states require consumers to purchase coverage for services that many consider quackery, such as acupuncture (12 states),

chiropractors (44 states), and naturopathy (4 states). Thirty-three states require consumers to purchase at least 40 types of mandated coverage. States have also required consumers to purchase coverage for medical treatments that later proved *harmful* to health, such as hormone replacement therapy (4 states) and high-dose chemotherapy with autologous bone marrow transplant for breast cancer (at least 1 state, Minnesota).

States impose many additional regulations on insurance pools, from premium taxes to rules limiting insurers' ability to manage utilization. The Congressional Budget Office estimates that, on average, state regulations increase the cost of health insurance by 13 percent. States prevent individuals (and employers) from avoiding unwanted regulatory costs by prohibiting them from purchasing health insurance from states with more consumer-friendly regulations.

To Stop the Bleeding, Repeal the ACA

Congress should repeal the ACA and replace it with reforms that allow better, more affordable, and more secure health care. The ACA's insurance regulations are sending health insurance into a downward spiral of low-quality coverage and higher premiums. If Congress repeals the Act, premiums would fall for millions of Americans who would no longer have to buy coverage they do not want or pay the hidden taxes that further increase their premiums. Consumers could once again purchase coverage that is more secure than either ACA coverage or employer-sponsored insurance. They would have the option to purchase preexisting conditions insurance, which would provide protection from the financial costs of long-term illness at a fraction of the cost of a standard health insurance plan. Consumers could look forward to the day when health insurance comes with a total-satisfaction guarantee and patients don't have to worry about their coverage—because it just works.

Merely repealing the ACA is not enough to improve quality and expand access for everyone currently receiving subsidies under its auspices. Federal and state policymakers must take additional steps outlined in this chapter and in Chapters 4, 14, 35, 37, 38, and 39. As Congress takes these steps to transition the U.S. health care sector from a government-run system to a market system, political necessity may require Congress to offer transitional assistance to the relatively small number who receive coverage under the ACA but would not see their premiums fall after repeal. Targeted assistance, perhaps in the form of a federally funded high-risk pool, could

be one of the purposes for which Congress allows the block grants recommended in Chapter 39.

Force Regulators to Compete

The original sin of health insurance regulation is not guaranteed issue, community rating, any-willing-provider laws, or mandated coverage laws. It is the insurance-licensing laws that make those regulations possible. Each state uses insurance-licensing laws to require every insurance policy sold to its residents to comply with all that state's regulations. Those laws prohibit individual insurance purchasers from joining insurance pools with residents of other states. And they prohibit residents from purchasing out-of-state insurance products that come with a different set of regulatory protections. As a result, they erect barriers to trade between the states and prevent individuals from shopping for consumer protections the same way they shop for other insurance features. In effect, insurance-licensing laws give each state's insurance regulators a monopoly over providing consumer protections. Those regulators then behave the way all monopolists do. They provide a low-quality product at an excessively high cost.

The best solution is for states to repeal insurance-licensing laws. Full liberalization would eliminate government's ability to use insurance regulations to redistribute income, or to shower rents on favored special interests. Government enforcement of contracts and competition would continue to provide the financial solvency protections and other safeguards that insurance purchasers demand.

If repealing insurance-licensing laws is politically infeasible, preliminary steps could provide nearly as much benefit to consumers. Under one approach, the federal or state governments would allow individuals and employers to purchase health insurance licensed by other states. If a purchaser is content with her own state's regulations, she could continue to purchase a policy regulated at home. But if her state imposes too many mandates, or prevents the insurance pool from protecting itself from irresponsible and opportunistic behavior, then the purchaser could choose an insurance plan with more consumer-friendly regulations. Economist Stephen Parente and colleagues estimate that

- letting individuals and employers purchase health insurance out of state could reduce the number of uninsured Americans by as many as 17 million, or one-third of the most-cited estimate of the number of uninsured; and

- when combined with tax reforms (see Chapter 37), this approach could cover as many as 24 million uninsured Americans.

"Regulatory federalism" would increase competition in health insurance markets. Insurers would face lower barriers to introducing products into new states. As a result, consumers would have much greater choice among cost-saving features (e.g., cost sharing and care management), provider financial incentives (fee-for-service and prepayment), and delivery systems (integrated, nonintegrated, and everything in between). (See Chapter 35.) Insurance pools would be more stable, and consumers would have more freedom to obtain coverage that fits their needs.

Perhaps most important, regulatory federalism would force insurance *regulators* to compete with one another to provide the optimal level of regulation. States that impose unwanted regulatory costs on insurance purchasers would see their residents' business—and their premium tax revenue—go elsewhere. The desire to retain premium tax revenue would drive states to eliminate unwanted, costly regulations and retain only those regulations that consumers value. One or a handful of states would likely emerge as the dominant regulators in a national marketplace, just as Delaware has created a niche for itself by offering a hospitable regulatory environment for corporate chartering.

Critics of this proposal do not want greater competition. Insurance regulators enjoy being monopoly providers. They would oppose threats to their monopoly position. The insurance industry would oppose regulatory federalism because it would subject them to greater competition as well. What regulator or insurance company wants to have to look over its shoulder to see if someone else might be doing a better job of managing insurance pools?

Competition benefits consumers. But regulators and insurers would paint this form of competition as a threat to consumers. Some critics claim that letting individuals and employers purchase coverage licensed by other states would lead to a race to the bottom. Others claim that some states would be so eager to attract premium tax revenue that they would eliminate all regulatory protections or skimp on enforcement.

In reality, both market and political forces would prevent a race to the bottom. As producers of regulatory protections, states are unlikely to attract or retain customers—insurers, employers, or individual purchasers—by offering an inferior product. Purchasers would avoid states whose regulations prove inadequate, and ultimately, so would insurers. The first people to be harmed by inadequate regulatory protections would likely be residents

of that state, who would then demand that their legislators enact better consumer protections. The result would not be zero regulation or a race to the bottom, but a race to equilibrium or multiple equilibriums—between too much and too little regulation—as consumers revealed their preferences.

Opponents of regulatory federalism also claim that consumers would have to travel to another state to have those protections enforced. On the contrary, those protections could be enforced in the consumer's state of residence. Not only could state courts enforce other states' laws, when appropriate, but another state's regulations could be incorporated into an insurance contract and enforced in the purchaser's home state. Such "choice-of-law" decisions are complicated and often disputed, but they are ultimately controlled by extensively developed legal doctrine and case precedents. Insurance regulators could even play a role in policing and enforcing other states' regulatory protections.

There is no reason not to allow consumers to choose where they purchase their health insurance. There are several options for implementing regulatory federalism. Ideally, each state would unilaterally give its residents the right to purchase insurance licensed by any other state. All a legislature need do is deem as licensed in its state any health insurance policy licensed by any of the other 49 states or the District of Columbia.

Though far from ideal, states could also give their residents a more limited right to purchase coverage out of state. They could allow residents to purchase insurance from select states, or they could enter into reciprocal compacts with other states. These approaches, however, would unnecessarily limit competition among insurers and regulators, as well as consumer choice. Reciprocal compacts would oddly condition each consumer's access to affordable health insurance on whether the legislature *of another* state is willing to do the right thing. Lowering this trade barrier unilaterally and completely is the more consumer-friendly option.

The best way to eliminate those trade barriers might be for Congress to do so. The Framers intended the United States to be a free-trade zone. Article I, Section 8, of the Constitution grants Congress the power to regulate commerce among the states, largely so that Congress can prevent states from erecting trade barriers that keep out products from other states. Insurance-licensing laws are a clear example of such trade barriers and a perfect target for congressional elimination. As with state-level reform, Congress need not alter any state's health insurance regulations. All that is necessary is for Congress to require each state to recognize the insurance licenses issued by the other states.

The Constitution, however, does not grant Congress the power to regulate health insurance. Thus, in the same legislation, Congress should relinquish any role as an insurance regulator. Were Congress to do otherwise, the federal government would (re)emerge as a monopoly provider of regulatory protections. Consumers would be even worse off than they are today. As they do under the ACA, rent-seeking special interests would storm Capitol Hill with demands for additional regulation. Federal regulations would be even further removed from the people than state regulations, and much more difficult to dislodge.

Any federal law aimed at regulatory federalism must do nothing more than allow consumers to purchase health insurance regulated by another state and ensure that those are the only regulations that govern. If Congress uses the opportunity to regulate health insurance itself, reform will not have been worth the effort.

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—Prepared by Michael F. Cannon

37. The Tax Treatment of Health Care

State legislators should

- avoid creating special tax treatment for health insurance or medical care; and
- eliminate existing tax preferences for health insurance and medical care while reducing the overall tax burden.

Congress should

- oppose refundable tax credits or other tax preferences or new categories of government spending;
- replace all existing health-related tax preferences with a tax preference for large health savings accounts; and subsequently
- adopt a new tax system that eliminates tax preferences for medical care and any other forms of consumption and reduces tax rates.

Markets are not free simply because we call them "private." Government can exert as much control over the private sector as the public sector, simply by ordering private individuals and firms to apply their resources toward the government's goals rather than their own.

Many presume the U.S. health care sector to be a market system because the private sector plays a greater role than in other advanced countries. The fact that the health care sector is more "private" and less "public" than in other nations tells us little about whether the United States has a market system. What matters—what determines real as opposed to nominal ownership, and whether a market is free or unfree—is who controls the nation's medical resources.

One of the most far-reaching and damaging ways government controls health care is through tax laws. Federal and state governments exempt

certain health-related uses of income from income and payroll taxes. In effect, these tax preferences mean government penalizes taxpayers who do not spend their money on the favored goods or services.

Government Penalizes Choice

The largest of these tax preferences is the exclusion of employer-sponsored health insurance from income and payroll taxes. Workers who obtain health insurance through an employer pay no income or payroll tax on the money the employer pays toward the premium, even though that "contribution" is income to them. Under so-called "Section 125" plans, many workers pay no tax on the portion of the premium they pay, either. As a result of the exclusion, federal and state tax codes effectively penalize workers who choose not to enroll in an employer-sponsored health plan; they pay higher taxes than workers who do. In 2016, the revenue loss to the federal government from the exclusion was $342 billion—five and a half times the size of the mortgage-interest deduction. That figure also represents an implicit threat: if employers stop offering coverage or workers stop enrolling in employer plans, workers would effectively have to pay a $342 billion penalty to the federal government.

A worker's health insurance premium and marginal tax rate determine the value of the tax exclusion, and the concomitant tax penalty it creates, for that worker. In 2015, the average family premium for job-based coverage was roughly $17,000. A worker's overall marginal tax rate can reach as high as 50 percent or more because it is the sum of her marginal payroll tax rate for Social Security and Medicare (up to 15.3 percent), her marginal federal income tax rate (up to 39.6 percent), and her marginal state income tax rate (up to 13.3 percent).

As a result, the federal tax code effectively penalizes workers thousands of dollars if they choose a health plan other than what their employer offers. After taxes, such workers can end up paying twice as much for less coverage. For 70 years, this hefty penalty has discouraged many workers from seeking insurance on the "individual" market. It is the principal reason more than 80 percent of Americans who have private health insurance get it through an employer.

The Exclusion Is a Form of Government Control, Not a Tax Cut

All targeted tax preferences reduce tax liability for those who engage in the preferred behavior—and therefore create an effective penalty on

those who do not. The tax exclusion for employer-sponsored health insurance is even worse. It reduces tax liability only for workers who surrender control over an even larger share of their earnings, and their choice of health plan, to their employer. Equivalently, it threatens workers with a tax penalty of thousands of dollars unless they surrender control over even more money to their employer.

The average employer "contribution" to family coverage is $13,000. Though it may seem counterintuitive, a survey of health economists found 91 percent of them agree that even though the employer writes that $13,000 check to an insurance company, the money comes out of the pockets of *workers*, not employers. The reason the "employer contribution" actually comes from workers is that employers take the money out of other forms of worker compensation. If employers weren't providing health benefits, they could not keep that money for themselves. Competition for labor from other employers would force them to give that money to workers in the form of higher cash wages or other benefits.

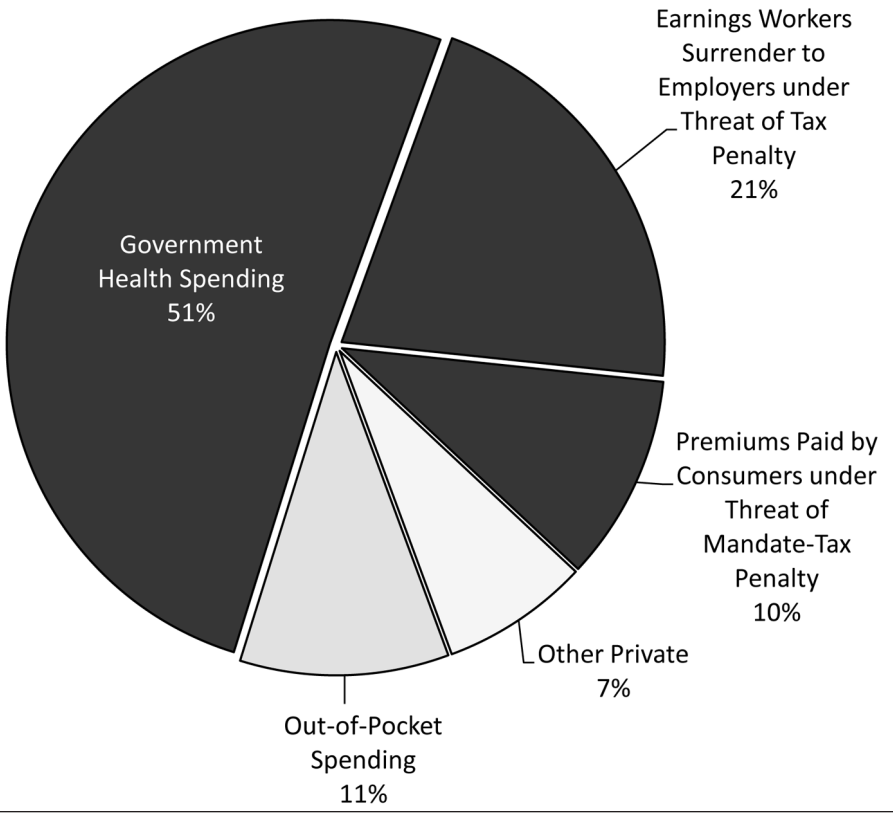
The exclusion can reduce a worker's tax liability by thousands of dollars—but only if she surrenders control over two or more times as much to her employer and lets her employer choose her health plan. If she does not, she pays thousands of dollars more in taxes than she otherwise would. This supposed tax cut literally penalizes workers who want to control their own money.

In effect, the tax preference for employer-sponsored insurance gives government control over $707 billion (21 percent) of the $3.6 trillion sloshing around America's health care sector (Figure 37.1). Federal and state tax laws penalize workers unless they surrender control over those earnings to an employer and enroll in coverage subject to government price controls and other regulations.

All told, this supposed tax "break" is comparable to the federal Medicare program (see Chapter 38) in terms of how many health care dollars it allows government to control (Figure 37.2).

The employer-sponsored insurance system—which covers 60 percent of Americans and has dominated the market since the 1940s—has more in common with a government program than a market system. In a market system, workers control their health care dollars and choose their own health plan. Under a government program, the government taxes them and uses their money to provide health insurance. Under the tax exclusion, government penalizes workers unless they surrender their health care dollars

Figure 37.1
Sources of Health Care Spending


Earnings Workers Surrender to Employers under Threat of Tax Penalty 21%
Government Health Spending 51%
Premiums Paid by Consumers under Threat of Mandate-Tax Penalty 10%
Other Private 7%
Out-of-Pocket Spending 11%

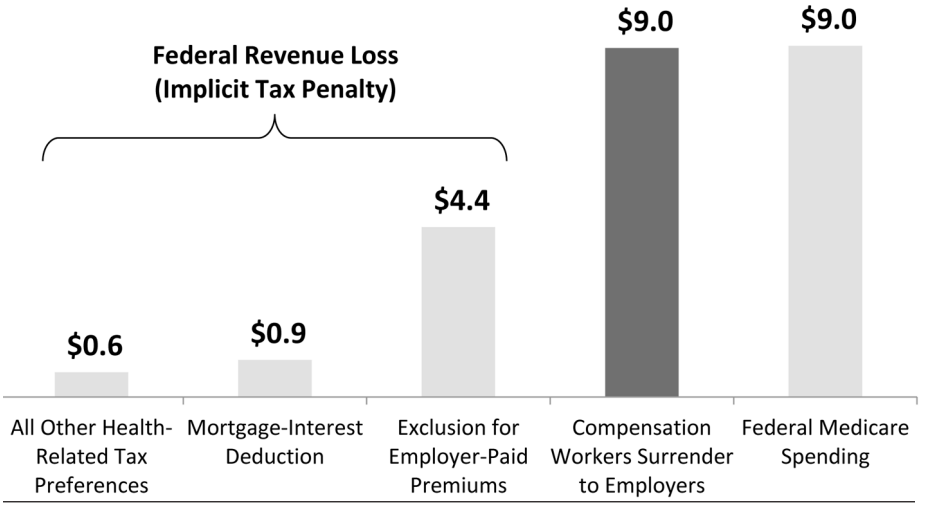
SOURCE: U.S. Centers for Medicare & Medicaid Services, Table 16—National Health Expenditures, by Type of Sponsor (2016).

and choice of health plan to a third party. The United States does not have, and never has had, a private or market-based health insurance system.

Employer-Sponsored Health Insurance Is Lousy Insurance

The tax exclusion has increased the cost and reduced the quality of health insurance in many ways. First, the exclusion increases health insurance premiums. Though workers pay for their job-based coverage through lower wages, that cost is not salient to them. They feel like they are spending someone else's money. The resulting lack of cost-consciousness causes workers to demand more health insurance than they would if they controlled their own health care dollars. It puts upward pressure on health insurance premiums, which persistently rise faster than wages.

Figure 37.2
Government Control of Health Spending: Tax Exclusion for Employer Coverage vs. Medicare, 2016–2025 (trillions of dollars)



SOURCE: U.S. Office of Management and Budget, U.S. Centers for Medicare & Medicaid Services, U.S. Congressional Budget Office.

Second, the exclusion increases health care prices. With that additional coverage, workers are—again—insulated from the cost of medical care. This second-order lack of cost-consciousness encourages workers to consume health care that provides little or no benefit and may even harm them. The added demand for medical care puts upward pressure on prices.

Third, the exclusion encourages wasteful and harmful care. Economist Alain Enthoven estimates that "less than 5 percent of the insured workforce can both choose a health plan and reap the full savings from choosing economically." So, when employers try to contain premiums with health plan features that discourage low-value care, such as cost sharing or managed care rules, workers revolt. Duke University professor Christopher Conover estimates the cost of all that additional care exceeded the benefits by $106 billion in 2002—a hidden tax that is no doubt larger today. The exclusion therefore contributes to estimates that as much as one-third of U.S. health spending is pure waste that does nothing to improve health.

Fourth, the exclusion reduces the quality of coverage by limiting workers' choice of plans. Because of the higher administrative costs of offering multiple plans, 83 percent of employers offer just one, and only 3 percent

offer more than two. Even when employees have a choice, the choice is typically between two plans from the same carrier. Economists Mark Pauly, Allison Percy, and Bradley Herring estimate the lack of choice alone imposes costs on workers of somewhere between 5 and 10 percent of premiums.

Fifth, the exclusion reduces the quality of care by inhibiting competition from entities that could potentially offer higher-value ways of financing and delivering health care. Enthoven argues that the exclusion holds back prepaid group practices like Kaiser Permanente, which have shown great promise in providing high-value care at a reasonable cost. Many workers may prefer such plans. The exclusion nevertheless prevents many employers from offering them. Prepaid group plans offer lower premiums in part by providing coverage only through limited networks of doctors and facilities. The exclusion obscures those savings such that they are not salient to workers. Workers therefore resist such plans, which seem to them like nothing but a cut in their compensation (see also Chapter 35).

Worst of all, the exclusion coerces workers into purchasing inherently lousy health insurance. A market system provides long-term protection against the cost of preexisting conditions for those with health insurance and even for the uninsured. As noted in Chapter 35, employer-sponsored insurance disappears when workers move, quit their jobs, get laid off, get fired, or become too sick to work; when their employer goes out of business, stops offering health benefits, or switches health plans; when they divorce or a spouse dies; or when they age off a parent's plan.

Prior to the Patient Protection and Affordable Care Act of 2010 (ACA), workers who lost their employer-based coverage after developing a preexisting condition often could not obtain coverage. Economists Mark Pauly and Robert Lieberthal found that tying health insurance to employment doubled the risk that workers in smaller firms with high-cost medical conditions will end up uninsured, relative to high-cost patients with individual-market coverage. Under the ACA, they still cannot obtain *quality* coverage. As discussed in Chapter 41, the ACA forces insurers to offer coverage that is increasingly unattractive to the sick and blocks innovations that would make health insurance more affordable and secure.

Employer-sponsored insurance creates the same sort of race to the bottom. Even before the ACA, federal law forbade employer plans to charge enrollees risk-based premiums. Government price controls based on "community rating" punish employers who offer coverage that is attractive to the sick, just as they punish insurers who do so. The adverse

selection they create can explain at least part of the gradual erosion in the number of workers covered by, and the comprehensiveness of, employer-sponsored plans.

A market system provides health insurance that stays with the policyholder from job to job and provides long-term protection against preexisting conditions. Federal and state governments penalized that type of insurance for decades, then effectively outlawed it.

The Affordable Care Act: More Taxes and Penalties

The ACA layered even more taxes, tax penalties, regulations, and government subsidies on top of those that had already been reducing the quality of health care while increasing its cost. Most notably, the ACA imposes community rating on all health insurance plans that were not already subject to such price controls. As explained in Chapter 36, the ACA has forced a race to the bottom in health insurance.

The ACA imposes additional taxes and penalties that further tighten the government's control over Americans' health care decisions—whether and where Americans purchase health insurance, and what kind of coverage they purchase. The ACA imposes an individual mandate that penalizes nearly all Americans who fail to purchase a government-defined health plan. If employers fail to provide a minimum level of coverage to employees, the ACA penalizes them $2,000 per worker. If an employer does not hide enough of the cost of that coverage in the form of foregone wages, the ACA penalizes the employer $3,000 per worker. The ACA imposes the penalties on employers, but ultimately they fall on workers themselves. The penalties even harm workers who comply. Economist Casey Mulligan estimates that even if firms comply, this "employer mandate" will depress wages by 1.3 percent for high-skilled workers, and by 3 percent for low-skilled workers.

The ACA imposes a 40-percent "Cadillac tax" on the portion of employer-sponsored health plan premiums that exceed $10,200 for self-only coverage and $27,500 for family coverage. (Thresholds rise each year with inflation.) The ACA originally specified the Cadillac tax would take effect in 2018, but Congress has since delayed its imposition until 2020. By 2028, an estimated 41 percent of small firms and 68 percent of large firms will have premiums that exceed the thresholds and will therefore be subject to the Cadillac tax. Again, even though the ACA levies this tax on employers, workers will ultimately bear the cost.

The ACA offers refundable "premium-assistance tax credits" to taxpayers who purchase coverage through an ACA exchange and have household incomes between 100 percent and 400 percent of the poverty level ($24,300 to $97,200 for a family of four). The ACA's tax credits are not actually tax cuts. Taxpayers pay the same amount to the IRS that they would if these credits did not exist. The ACA just directs the IRS to send the taxpayer's "tax credit" to the taxpayer's insurance company. Moreover, the ACA's tax credits are 94 percent government spending. Taxpayers who receive (if that's the right word) the ACA's tax credits pay only enough in income taxes to offset 6 percent of the funds the IRS sends to their insurance companies on their behalf. The remaining 94 percent comes from other taxpayers.

In sum, with the ACA, tax laws now penalize workers thousands of dollars if they don't surrender control over a signification portion of their earnings to an employer, and again if they surrender control over too little of their earnings. Tax laws further penalize workers if their employer doesn't offer coverage, doesn't offer enough coverage, or offers too much coverage. If their employer doesn't offer coverage, tax laws penalize workers again if they don't obtain coverage, or enough coverage, on their own. One consequence of all these penalties is that the definitions of what coverage taxpayers must purchase to avoid the penalties are enough to give government control over every aspect of "private" health insurance.

Reforming Health Care via the Tax Code

Like government subsidies, targeted tax preferences create waste and inhibit innovation. They encourage taxpayers to spend money on low-value items. They reward producers who provide that which the government favors—and those who lobby for more favors—rather than producers who create something better.

Ideally, government would offer *no* special tax breaks for health-related expenditures. The purpose of taxes should be solely to raise revenue for government. If the government must impose a tax, it should distort how individuals cast their "dollar votes" as little as possible. Creating special tax breaks for certain types of behavior—and thereby imposing concomitant tax penalties on other behaviors—is just one more illegitimate (yet pervasive) tool governments use to control free people. If politicians want to subsidize an item like medical care, they should raise general taxes and spend the revenue on that item.

Therefore, the ultimate goal of tax-based health care reform should be to eliminate all tax breaks for health-related uses of income, and to tax medical consumption like any other consumption. Consumers should choose for themselves whether, where, and how much health insurance and medical care to purchase. Those decisions should reflect the values of each individual, not the values of special-interest groups and politicians who worm special favors into the tax code.

Eliminating tax breaks can be problematic both in principle and for political reasons. All else equal, eliminating a targeted tax preference brings more revenue into government coffers. If that indirectly causes government spending to rise, then eliminating a targeted tax break can increase government's claim on economic resources. (If instead the added revenue reduces government debt, then it merely shifts the burden of government spending from future taxpayers to current taxpayers.) Eliminating the tax break for employer-sponsored insurance would raise taxes on most U.S. workers by requiring them to pay payroll and income taxes on the value of their health insurance premiums. Workers are therefore likely to resist reforms that merely eliminate health-related tax breaks.

A more sensible approach would eliminate those tax breaks and also reduce payroll and income tax rates to a point where the overall amount of revenue raised remains constant or even falls. Even if overall tax revenues remained unchanged, some individuals would pay less in taxes and others would pay more. The latter group—typically those with the most expensive employer-sponsored health benefits—would still resist reform. In the short term, therefore, it may be politically infeasible to eliminate health-related tax breaks completely.

As a preliminary step, Congress should enact tax reforms that reduce tax-based distortions within the health care sector and prepare consumers and the health care sector to transition to a new tax system with no health-related tax breaks. Congress took a small step in that direction by creating tax-free health savings accounts (HSAs).

Employer contributions to a worker's HSA enjoy the same preferred tax status as employer-paid insurance premiums. As a result, workers do not have to surrender those earnings to their employer to obtain the tax break, and HSAs enable workers to save money for their health care expenses tax free. Taxpayers can also make tax-preferred contributions themselves. HSA funds belong to the individual, follow her from job to job, and grow tax free. Account holders can use HSA funds to purchase qualified medical expenses, tax free, from any source.

Still, HSAs enable workers to control only a small portion of the dollars and decisions that tax laws allow employers to control. HSAs create tax parity only for the funds that account holders contribute to the HSA to cover out-of-pocket medical expenses. If workers want to purchase their own health insurance, generally they must still pay the premiums with after-tax dollars. Only consumers with insurance that meets Congress's rigid definition of a "qualified high-deductible health plan" can make tax-free HSA deposits. HSAs are small comfort to workers whose employer doesn't offer them, or who dislike the one narrow type of health plan Congress permits HSA holders to obtain.

Nevertheless, HSAs present an opportunity to enact reforms that would make health care better, more affordable, and more secure. Congress should take three steps to expand HSAs:

- increase HSA contribution limits dramatically, say, from $3,400 for individuals and $6,750 for families to $9,000 and $18,000;
- remove the requirement that HSA holders obtain a qualified high-deductible health plan, or any type of health plan; and
- allow HSA holders to purchase health insurance, of any type and from any source, tax free with HSA funds.

Replacing all existing health-related tax preferences with one tax break for large HSAs would let workers with family coverage control an average $13,000 of their income that their employer currently controls. It would reduce all tax-code distortions within the health care sector, freeing workers to choose their doctor and their health plans. It would also minimize political resistance to reform.

How Would Large HSAs Work?

For workers who receive family coverage through an employer, the average premium is $17,000 per year, of which the employer pays $13,000 and the worker pays $4,000. With large HSAs, rather than divert $13,000 from the worker's cash compensation to health benefits, the employer would add that amount to the worker's salary. The worker would then decide how much to contribute to her HSA, up to the contribution limit (e.g., $18,000). The tax code would exclude those contributions from both income and payroll taxes, just as it excludes employer-paid health premiums today. The worker could then use her HSA funds to purchase health insurance, of any type, from her employer or another source, tax

free. If she likes her employer plan, she could stay put. Or she could choose a policy that stays with her family throughout life's many changes.

With large HSAs, the tax code would no longer distort Americans' decisions about whether to purchase health insurance or save for their medical expenses, where to purchase coverage, or what type of coverage to purchase. Unlike today, the worker would own every dime she spends on coverage and care and would seek out health plans and providers who deliver value for the money.

What Would Large HSAs Do?

Aside from reforming Medicare (see Chapter 38), authorizing large HSAs may be the single most important thing Congress can do to make health care better, more affordable, and more secure. In particular, it may be the single most important thing Congress can do to bring medical care within the reach of the poor.

Each year, large HSAs would shift control over some $707 billion, or 21 percent of total U.S. health care spending, from employers to the workers who earned it. That transfer of power would dramatically transform U.S. health care for the better. Large HSAs would reduce barriers to innovative insurance products. Workers could choose any health plan they like and would become cost-conscious when shopping for insurance in a way they have never been. This dynamic would eliminate the tax code's barriers to prepaid group plans and thereby bring innovations like comparative-effectiveness research, electronic medical records, and coordinated care within the reach of hundreds of millions of Americans. The change would drive down prices by encouraging the growth of retail clinics and removing barriers to reverse deductibles, which have saved consumers thousands of dollars on medical procedures (see Chapter 35). Large HSAs could change the politics of health care by making consumers more conscious of the costs of government regulation.

Large HSAs versus Other Proposals

Large HSAs have distinct advantages over other options for reforming the tax treatment of health care, including a cap on the exclusion, refundable tax credits, full deductibility for all medical spending, and a standard deduction for health insurance. Any reform that achieves tax parity between employer-sponsored health insurance and other forms of insurance (e.g., tax credits, a standard deduction) will cause a certain amount of uncertainty

and anxiety. Will healthy workers stay in their employer's health plan? Will premiums for older, sicker workers who remain become unaffordable? If so, competition among employers will return to those workers the $13,000 that employers had been spending on their health benefits—and that will help. There is uncertainty, however, about when workers will get those funds.

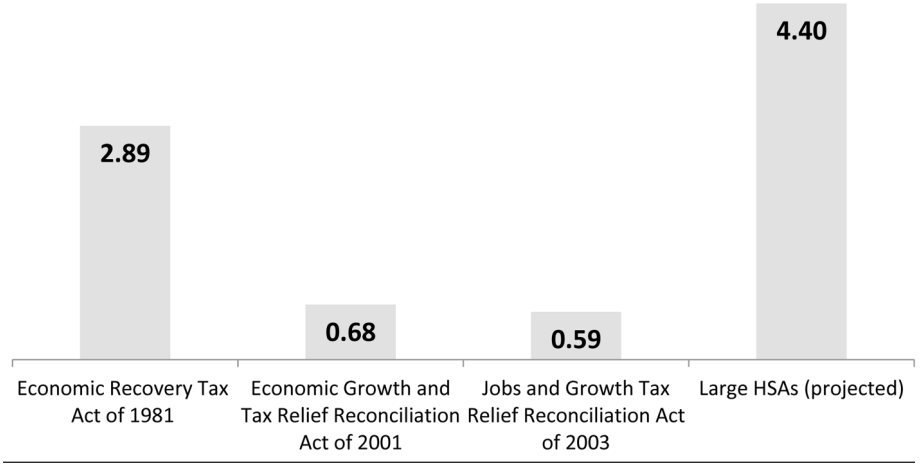
The only tax reform that includes a mechanism to return $13,000 immediately to the vast majority of workers is the large HSA. It would therefore do more than other reforms to reduce uncertainty for workers, particularly high-risk workers, and would minimize political opposition to reform. Suppose, for example, Congress legislates that large HSAs will take effect on January 1. When January 1 arrives, the transition for most workers would be seamless. Far in advance of that date, workers would demand, and competition among employers would ensure, that employers would increase workers' annual cash wages by around $13,000 as of January 1. Workers would then decide how much of their earnings to deposit in a large HSA and would use those funds to pay their health premiums. If they wanted to stay with their employer plan, they might not even notice any change.

Large HSAs would minimize political opposition to reform by giving all affected workers a large net tax cut. With contribution limits in the neighborhood of $9,000 and $18,000, nearly all workers could exempt as much income from taxation as they did when their employers were paying their premiums. Only a small and relatively wealthy number of workers have employer-plan premiums that exceed those amounts; those few would have some income that would become subject to income and payroll taxes.

Yet, large HSAs would be an effective tax cut for all workers—even those who would end up paying more to the Internal Revenue Service. Large HSAs would give all workers ownership and control over the first $9,000 or $18,000 of their health care dollars. Returning money to the people who earned it is a tax cut. Over a 10-year period, large HSAs would return to workers $9 trillion of their earnings that current law allows employers to control. As a share of gross domestic product (GDP), that is a larger effective tax cut than the 1981 Reagan tax cuts plus the 2001 and 2003 Bush tax cuts, combined (Figure 37.3). That effective tax cut would totally swamp the relatively small additional tax liability that some high-income workers would have to pay.

Alternative tax reforms would preserve government control and are less politically feasible. Capping the exclusion—which the Cadillac tax will

Figure 37.3
Effective Tax Cut from Large HSAs Relative to Previous Tax Cuts: Earnings Returned to Workers as a Percentage of GDP (Four-Year Average)



SOURCE: U.S. Department of the Treasury, U.S. Centers for Medicare & Medicaid Services, and author's calculations.

do if Congress ever lets it take effect—neither gives workers ownership of their health care dollars nor achieves parity between job-based and other forms of insurance.

Health insurance tax credits would preserve the worst features of the ACA. Replacing the exclusion with a uniform tax credit would increase taxes on many workers. Creating a tax credit only for those without access to employer-sponsored insurance (as the ACA does) would increase federal deficits. Either option would threaten to unravel employer-based plans while doing nothing to give workers immediate control of that $13,000, which workers with expensive medical needs would need to weather the changes. Making a tax credit refundable would mimic even more features of the ACA by dramatically increasing both government spending and the overall tax burden. Any refundable health insurance tax credit proposal would simply be a repackaged version of the ACA. It would increase taxes and redistribute income, penalize taxpayers who do not purchase a government-defined health plan, give government as much control over health insurance markets as the ACA does, and suppress innovation.

Full deductibility for all medical spending—as advocated by economists John Cogan, Glenn Hubbard, and Daniel Kessler—would neither give

workers ownership of their earnings, nor level the playing field, nor contain the economic distortions due to health-related tax breaks.

A standard deduction for health insurance would dramatically reduce the tax code's influence over consumer decisionmaking. Yet, even that reform would suppress innovation, allow government to control health insurance markets, and do nothing to alleviate the uncertainty about what will become of workers' $13,000 when Congress levels the playing field between employment-based and other forms of insurance. Indeed, that uncertainty may be the most significant (if unacknowledged) obstacle to fundamental tax reform. If Congress attempts fundamental tax reform without first giving workers ownership of that $13,000, and giving consumers time to learn how to navigate health insurance markets, opponents will rail against it and likely succeed in killing the reform. To do so, they need only frighten a small share of the 160 million Americans with employment-based health insurance.

Endgame: Tax Neutrality for Health Care

Large HSAs would allow tax reform to proceed in two steps. First, they would give consumers control of the money that employers now spend on their behalf and would acclimate consumers to making their own health insurance decisions. Consumers are likely to appreciate the option of purchasing health insurance that doesn't disappear when they get sick and lose their jobs.

Second, large HSAs would make it far easier for Congress to transition to a flat, fair, or national sales tax. Congress could enact reform without the obstacle of consumers' anxieties about whether they will be able to keep their health insurance, or whether employers will return to them what is rightfully theirs.

Suggested Readings

Cannon, Michael F. "Health Care's Future Is So Bright, I Gotta Wear Shades." *Willamette Law Review* 51, no. 4 (Summer 2015): 559–71.

———. "Health Savings Accounts: Do the Critics Have a Point?" Cato Institute Policy Analysis no. 569, May 30, 2006.

———. "Large Health Savings Accounts: A Step toward Tax Neutrality for Health Care." *Forum for Health Economics & Policy* 11, no. 2 (2008).

Cannon, Michael F., and Michael D. Tanner. *Healthy Competition: What's Holding Back Health Care and How to Free It*. Washington: Cato Institute, 2007.

Cochrane, John. "Time-Consistent Health Insurance." *Journal of Political Economy* 103, no. 3 (1995): 445–73.

Mulligan, Casey B. *Side Effects and Complications: The Economic Consequences of Health-Care Reform*. Chicago, IL: University of Chicago Press, 2015.

Pauly, Mark V., and Robert D. Lieberthal. "How Risky Is Individual Health Insurance?" *Health Affairs* 27, no. 3 (2008).

Pauly, Mark, Allison Percy, and Bradley Herring. "Individual versus Job-Based Insurance: Weighing the Pros and Cons." *Health Affairs* 18, no. 6 (1999): 28–44.

—Prepared by Michael F. Cannon

38. Medicare

Congress should

- allow seniors to opt out of Medicare without losing Social Security benefits;
- limit the growth of Medicare spending to the level of growth in GDP;
- take all the money Congress currently spends on Medicare and give it directly to enrollees as cash, as with Social Security, adjusting individual enrollees' "Medicare checks" so that lower-income and sicker enrollees receive larger checks;
- allow workers to save their Medicare payroll taxes in personal, inheritable retirement health savings accounts that will gradually replace Medicare transfers; and
- fund any transition costs by reducing other government spending, not by raising taxes.

Medicare is a $600 billion federal entitlement program that provides health insurance to nearly 60 million Americans who are elderly or disabled or meet other criteria. It is the largest purchaser of health care goods and services in the world and effectively controls even more of the U.S. health care sector than federal Medicare outlays suggest. It is also the single greatest obstacle to making U.S. health care better, more affordable, and more secure.

Medicare is lousy health insurance. When people complain about excessive U.S. health spending, they are complaining about Medicare. When they complain about the fee-for-service payment system; about wasteful care, harmful care, and medical errors; about health care fraud and excessive profits; about federal deficits and debt, the time bomb of entitlement

spending, and special-interest influence over health care; about the lack of innovation, evidence-based medicine, electronic medical records, accountable care organizations, telemedicine, and coordinated care, they are complaining in every case about *Medicare*.

Since 1965, Medicare has blocked innovations that would improve health care, to say nothing of how it has denied workers the right to control their earnings. Supporters claim that Medicare is more efficient than private insurance because it has lower administrative costs. To reach that conclusion, they ignore many of Medicare's administrative costs, in particular the "excess burden" of taxation, or the reduction in economic output caused by all the taxes necessary to finance Medicare spending. Estimates place those costs between 20 percent and 100 percent of Medicare expenditures, dwarfing any administrative costs of private insurance. Decades of reports by government watchdogs demonstrate that the main way Medicare avoids administrative costs is by failing to conduct oversight. The result is rampant waste and fraud. The Government Accountability Office reports that 13 percent of traditional Medicare payments in 2014 were fraudulent or improper. Medicare's low administrative spending is one of its flaws, not one of its virtues.

Perhaps Medicare's only success has been to concentrate power in Washington, D.C. It is indeed popular among enrollees—not because it is better than the alternatives, but because it has eliminated better alternatives and thereby made seniors and the disabled utterly dependent on the government for their health care.

Low-Quality Care

A landmark study by economists Amy Finkelstein and Robin McKnight made the following conclusion:

> Using several different empirical approaches, we find no evidence that the introduction of nearly universal health insurance for the elderly had an impact on overall elderly mortality in its first 10 years. . . . Our findings suggest that Medicare did not play a role in the substantial declines in elderly mortality that immediately followed the introduction of Medicare.

The authors estimated that the reduction in out-of-pocket medical spending among seniors that followed Medicare's introduction produced benefits of less than 40 percent of the program's total cost. Data limitations prevented them from estimating any nonmortality health benefits from Medicare. Nevertheless, at a minimum, Medicare appears not to have

saved a single life in its first decade, calling into question whether the program has been net beneficial. Elsewhere, Finkelstein found evidence that Medicare has been a driving force behind the growth of health spending on both the elderly and the nonelderly.

Additional evidence suggests Medicare may not pass a cost–benefit test. The Dartmouth Atlas of Health Care and other researchers estimate that a third or more of Medicare spending provides no value whatsoever: it makes the patient no healthier or happier. If we were to add to that figure spending on services whose costs exceed the benefit to the patient, it would show an even larger share of Medicare spending to be wasteful. As noted in Chapter 35, Medicare may be one of the factors behind the United States' leading role in developing new diagnostic tests and medical treatments. If so, it appears that once those goods and services become available, Medicare pays for them whether or not they benefit a particular patient.

One factor that contributes to the epidemic of wasteful Medicare spending is that the program generally provides open-ended subsidies for whatever medical care providers recommend. The Medicare Payment Advisory Commission (MedPAC) is a federal bureaucracy that advises Congress on how to set prices and other terms of exchange with Medicare-participating providers. MedPAC itself reported the following:

> Medicare, the largest single payer in the system, pays all of its health care providers without differentiation based on quality. Providers who improve quality are not rewarded for their efforts. In fact, Medicare often pays *more* when a serious illness or injury occurs or recurs while patients are under the system's care. The incentives of this system are neutral or negative toward improving the quality of care. [emphasis added]

Medicare generally pays providers on a "fee-for-service" basis, meaning a separate fee for each individual service or hospitalization, rather than paying for a particular health outcome (which can be exceedingly difficult) or paying a fixed or "capitated" amount per patient. Fee-for-service payment has benefits: it gives patients a wide choice of providers, for example. However, it creates incentives for providers to recommend services that offer little or no benefit, even services that end up being harmful. It allows multiple providers to treat a shared patient without coordinating their efforts (a job that then falls to the patient). Medicare even rewards medical errors and punishes efforts to reduce them. When a medical error results in the patient's requiring more services, Medicare pays for the initial, harmful service and pays *again* for the remedial care. Medicare thus pays

hospitals and other providers less when they improve the quality of care by reducing medical errors. This system fuels the problems of wasteful spending and medical errors.

By heavily subsidizing fee-for-service payments and fragmented delivery, Medicare prevents competition that could lead to alternative ways of financing and delivering medical care. A market system would find ways to reduce wasteful care and medical errors and to promote coordinated care, electronic medical records, effectiveness research, and evidence-based medicine. In particular, Medicare has inhibited competition from integrated, prepaid group plans such as Kaiser Permanente and Group Health Cooperative (see Chapter 35). Along with other government interventions—such as clinician licensing and the tax preference for employer-sponsored insurance (see Chapter 37)—Medicare has dramatically tilted the playing field in favor of fee-for-service payment and uncoordinated care.

Congress has attempted to mitigate the perverse incentives and unintended consequences of Medicare's payment systems. Various tweaks and demonstration programs have tried to eliminate financial rewards for medical errors, promote coordinated care, and fund effectiveness research. Yet demonstration programs aimed at improving quality or reducing spending in Medicare have not been successful.

The Dinosaur's Veto

There are *reasons* such efforts are not successful. Any effort to increase quality or reduce costs in Medicare represents a threat to high-cost, low-quality providers. If those efforts are voluntary, inefficient providers just avoid them and keep getting paid for doing what they have always done. Analyst Robert Laszewski describes this dynamic in the context of the Affordable Care Act's (ACA) attempt to promote "accountable care organizations" (ACOs). "Here's a flash for the policy wonks pushing ACOs: They only work if the provider gets paid less for the same patient population. Why would they be dumb enough to voluntarily accept that outcome?"

Reforms intended to force Medicare-participating providers to become more efficient usually die under intense lobbying from the high-cost, low-quality providers who stand to lose. A market system would force those providers out of business. Instead, Medicare creates a dinosaur's veto that allows lousy providers to protect their revenue streams and sticks Medicare patients and taxpayers with low-quality, high-cost care.

Medicare Advantage

One bright spot, of sorts, is the Medicare Advantage program. Traditionally, Medicare has been a government-run health insurance scheme that writes checks directly to doctors, hospitals, and other providers. In the Medicare Advantage program, the government pays insurance companies to play that role. Medicare enrollees may choose among competing Medicare Advantage plans, which often offer more coverage than traditional Medicare. Some 30 percent of enrollees opt for Medicare Advantage plans, a share the Congressional Budget Office projects will grow to 40 percent by 2026. In effect, Medicare Advantage plans compete for enrollees against the "public option" of traditional Medicare.

Medicare Advantage creates more competition in the delivery of medicine by extending government subsidies to different ways of financing and organizing health care. Some Medicare Advantage plans are fully integrated and capitated plans, such as Kaiser Permanente. Others are fee-for-service plans like traditional Medicare. Other plans fall somewhere in between.

Medicare Advantage mitigates some of the problems traditional Medicare creates. A former chief executive of Kaiser Permanente—the original accountable care organization—noted that the ACA's effort to tweak traditional Medicare's payment systems "is not as good as [the] Medicare Advantage program" at promoting integrated, accountable care. One review of the literature found that Medicare Advantage plans score higher on some quality measures, including use of preventive care. Medicare Advantage health maintenance organizations appear to do a better job of avoiding unnecessary hospitalizations and encouraging less-expensive care. One study estimated that Medicare Advantage plans reduce hospitalizations by a third without any negative impact on mortality. Medicare Advantage appears to have spillover effects that reduce unnecessary spending in traditional Medicare.

There is nothing inherently superior about the government writing checks to insurance companies instead of health care providers, however. There is evidence Medicare pays more to cover enrollees through Medicare Advantage than it would cost to cover them through traditional Medicare. The projected growth in Medicare Advantage enrollment suggests this may be the case. This may be because participating insurers tend to market themselves to Medicare enrollees who will cost them less (and to avoid patients who would cost them more) than the government is paying. The result is akin to the dynamic in the ACA's Exchanges: government-determined prices lead insurers to make their plans attractive to relatively

healthy enrollees and unattractive to relatively sick enrollees. Traditional Medicare receives higher marks from enrollees with expensive illnesses, likely because it provides relatively—albeit dangerously—easy access to care.

To build on the meager progress of Medicare Advantage, Congress should take three steps to liberalize health care for the elderly and disabled.

Reform: Sever the Tie between Medicare and Social Security

At present, people who are eligible for Medicare but do not enroll forfeit all Social Security benefits—past and future. Conditions on government subsidies become problematic when they require recipients to accept a second government subsidy. The main problem with this condition, however, is that it has no basis in statute. Federal bureaucrats just made it up. It is fairly clear why they did. Withholding Social Security benefits makes it harder for seniors to leave Medicare, which has the effect of both quashing the market for alternative forms of health insurance and making more Americans dependent on Medicare.

Congress should allow seniors to opt out of Medicare without losing Social Security benefits. Removing this condition would curb executive overreach, expand the market for alternatives to Medicare, and create a political constituency of seniors that is more open to fundamental Medicare reform.

Reform: Make Medicare like Social Security

The single, most dramatic thing Congress can do to make health care better, more affordable, and more secure is to take the $600 billion it currently spends on Medicare and simply give it to Medicare enrollees as cash. Currently, Medicare sends those billions to providers and insurers, who fight fiercely to protect their revenue streams, and who can increase their haul by providing more low-quality services or lobbying for greater subsidies. Seniors often join providers and insurers to lobby for protecting or expanding access to low-quality care—because it is taxpayers' money on the line, not their own. The rules Medicare attaches to these subsidies stifle innovation, while keeping quality low and costs high.

One bipartisan proposal would create a more level playing field between traditional Medicare and private plans. “Premium support” would give enrollees a fixed subsidy they could apply toward either traditional Medicare or the private health plan of their choice. A fixed subsidy would

encourage enrollees to choose less wasteful coverage. If enrollees chose plans that cost more than their premium subsidy, they would pay the balance. If they chose a less expensive plan, they could keep the unspent portion of their subsidy, perhaps in a health savings account. A level playing field would reveal to enrollees the full cost of all health plans and allow enrollees to decide which ones provide the greatest value. Efficient and innovative health plans would thrive. The rest would not.

Premium support is a step in the right direction. It would acclimate more enrollees to choosing their health plans and being cost-conscious consumers. But Medicare would continue to suppress desperately needed innovations. And the government would still be in the business of specifying rules for participating insurers (e.g., what types of coverage they must offer) and prices and other terms of exchange for providers participating in traditional Medicare. It is simply not possible to level the playing field between government and private-sector competitors. For example, private insurers pay taxes; government programs don't.

Converting Medicare into a program like Social Security—that is, distributing cash to beneficiaries—would spark an innovation revolution. Enrollees could receive "Medicare checks" at the same time they receive their Social Security checks. Medicare checks would average more than $10,000 per enrollee per year. Enrollees could use those funds to purchase the health plan of their choice at actuarially fair rates. Enrollees who want more expensive health insurance could supplement their subsidy with private funds, just as they do now with Medicare Advantage and Medigap plans. Alternatively, seniors who choose a lower-cost plan could save their extra health care dollars in a tax-free health savings account.

The size of each enrollee's Medicare check would depend on their health status and income. When an individual enrolls in the program, Medicare would use competitive bidding or risk-adjustment formulas to adjust the amount of that enrollee's check according to that individual enrollee's health status. It would use Social Security Administration data to calibrate the amount of the enrollee's check according to the enrollee's lifetime income. Low-income and sicker enrollees would get Medicare checks large enough to enable them to afford a standard package of insurance benefits. Healthier and higher-income enrollees would get smaller checks. As with Social Security, enrollees would then be free to spend that money as they see fit. They could use their Medicare checks to purchase whatever health plan they choose, to purchase preexisting conditions insurance (see Chapter 36), to save for future medical expenses, or to purchase other items, like

tuition for their grandchildren. The availability of guaranteed-renewable health insurance (see Chapter 36), and the fact that Medicare would use lifetime rather than current income to adjust for income, means Medicare would only need to adjust for income and health status once, at enrollment. If enrollment growth times medical inflation grows faster than gross domestic product (GDP), Medicare would reduce checks for healthier and higher-income enrollees to preserve the ability of sicker and low-income enrollees to afford a standard package of insurance benefits.

Critics worry that, to the extent the risk-adjustment does not perfectly track the risk of health claims, some enrollees would have insufficient funds to purchase health plans at actuarially fair rates. This objection fails for two reasons. First, to the extent Medicare's competitive-bidding processes or risk-adjustment formulas are imperfect, they are already harming the sick by leading Medicare Advantage plans to avoid relatively sick enrollees. Second, even when the government imperfectly calibrates the amount, giving the money to enrollees would create incentives for insurers to find innovative ways to cover the sick, rather than to avoid them. If Medicare can risk-adjust the payments it makes to insurance companies, then there is no reason not to give that money directly to enrollees.

Another objection is that, whereas Medicare currently offers an open-ended entitlement to health care subsidies, giving enrollees a fixed subsidy means some enrollees would run out of money. That could happen if enrollees' current income and assets were less than their lifetime income would suggest, or if enrollees frittered away their subsidy. Implicit in the latter concern is the worry that Medicare enrollees could not spend $600 billion as competently as government bureaucrats can. This objection likewise fails. If any enrollees were to run out of money, they would most likely become eligible for Medicaid (see Chapter 39).

More important, enrollees are unlikely to run out of money because consumers can make $600 billion go a lot farther than the government can. First, subsidizing seniors with cash would encourage cost-saving innovations. Medicare enrollees would spend that $600 billion much more cost-consciously when it is *their* money than when it is the taxpayers' money. That would put downward pressure on prices in a way Medicare simply cannot. Enrollee cost-consciousness would spark and reward innovations like the "reverse deductibles" (discussed in Chapter 36) that have led to price reductions of thousands or tens of thousands of dollars. Second, it would remove regulatory barriers to such innovations. Removing Medicare from its role as a purchaser of medical services would eliminate

the restrictive price and exchange controls that have stifled innovation in health care delivery. Finally, Medicare checks would come with a built-in buffer. Ironically, the fact that Medicare likely wastes at least one out of every three dollars means enrollees could waste one-third or more of that $600 billion without any adverse health effects for the average enrollee. All that wasteful Medicare spending is usually a problem. When reforming Medicare, it is an absolute boon.

Reforming Medicare by letting enrollees control that $600 billion would end federal micromanagement of the health care sector. It would spark an innovation revolution by allowing the consumers' choices and competition—rather than a government bureaucracy—to determine prices, payment systems, delivery systems, and how to reward quality. It would unlock the potential of integrated delivery systems, effectiveness research, coordinated care, and other reforms that Medicare is struggling—and failing—to deliver. Just as Medicare has spillover effects that increase costs for non-Medicare patients, and just as Medicare Advantage has spillover effects that reduce spending in traditional Medicare, both elderly and nonelderly patients would see the benefits of these innovations in the form of better, more affordable, and more secure health care.

Reform: Prefund Retiree Health Care

Finally, Congress should replace Medicare's inequitable system of intergenerational transfers with a prefunded system in which workers invest their Medicare taxes in personal accounts dedicated to their own health needs in retirement. Congress should allow workers to put their full Medicare payroll tax payment in a personal savings account. Workers could invest those funds in a number of vehicles and augment those funds in retirement with other savings. Over time, Congress could make contributions to these personal accounts voluntary.

This proposal for Medicare personal accounts is similar to many Social Security reform proposals (see Chapter 40). One similarity is that diverting workers' tax payments into personal accounts would make it difficult to pay current benefits. Congress could make up much of those "transition costs" by cutting Medicare outlays. As noted earlier, an estimated one-third of Medicare outlays do nothing to improve beneficiaries' health or make them any happier. Thus, Congress could allow per-enrollee Medicare spending to grow at a rate less than GDP without harming the health of enrollees. If Congress is unable or unwilling to cover all transition costs

by reducing Medicare outlays, it should make up the gap by cutting other government spending (see Chapter 32)—not by raising taxes.

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—Prepared by Michael F. Cannon

39. Medicaid and the State Children's Health Insurance Program

State legislators should

- refuse to implement the Patient Protection and Affordable Care Act's Medicaid expansion;
- conduct randomized, controlled experiments of the effects of Medicaid and the State Children's Health Insurance Program (SCHIP), along the lines of the Oregon Health Insurance Experiment, with existing populations;
- deregulate medical care and health insurance; and
- demand that the federal government grant states flexibility with the existing Medicaid and SCHIP programs, not additional funds, to provide medical and long-term care to the needy.

Congress should

- repeal the Patient Protection and Affordable Care Act;
- liberalize Medicare and the tax treatment of health insurance;
- deregulate health care and health insurance;
- permit states to conduct randomized, controlled experiments of the effects of Medicaid and SCHIP coverage on existing populations;
- eliminate any federal entitlement to Medicaid or SCHIP benefits;
- freeze each state's Medicaid and SCHIP funding at current-year levels;
- give states full flexibility to use Medicaid and SCHIP funds to achieve a few broad goals; and
- begin phasing out Medicaid and SCHIP federal funding.

Counterintuitively, the most important thing policymakers can do to improve access to care for the poor is not to provide direct assistance to the poor, but to liberalize the health care sector. The great virtue of a market system is that it uses innovation to fill in the cracks in the health care sector so that fewer vulnerable patients fall through. A market system drives prices for medical care and health insurance downward. It minimizes the problem of preexisting conditions by offering protection against preexisting conditions even to the uninsured. Liberalization would reduce unmet medical need by bringing health care within the reach of those who could not previously afford it, making health care of ever-increasing quality available to an ever-increasing number of people. Liberalization would make the problem of unmet need smaller and leave the rest of society wealthier, so we could better help the shrinking number of patients who still could not help themselves. Government intervention merely causes the cracks in the health care sector to widen.

Even so, no matter how well a market system improves quality and access, there will always be patients who cannot afford the medical care they need, either because they never had the resources or because they chose not to purchase health insurance. This chapter discusses how to address, in a market system, the shrinking number of patients who cannot help themselves.

The Samaritan's Dilemma

Any effort to help people in need confronts what economists call "the Samaritan's dilemma"—the idea that, just as it is possible to help too little, it is also possible to help too much. Helping too much induces people who could be self-reliant to take advantage of charitable assistance and do less to help themselves. As the assistance becomes more generous, fewer people provide for themselves. They contribute less to the economy—and to charity. Helping too much perversely *increases* the amount of "need" and the burden of charity, while simultaneously reducing society's ability to bear that larger burden.

Ideally, voluntary charity and government assistance would avoid both helping too little and helping too much. Yet there is no obvious "right" place to strike that balance. The optimal amount of charitable assistance depends on actual need, the costs of assistance and dependence, and donor preferences. All of these vary across space and time.

Some approaches are more effective than others. Voluntary charities have the incentive and the ability to ensure their resources assist only the

truly needy. For example, voluntary charities can lose funding if donors learn their contributions are going to people who don't need assistance. In contrast, the government has little incentive or ability to strike an optimal balance. Politicians must craft broad eligibility rules for government programs. Typically, these take the form of a legal entitlement to benefits for anyone who meets certain criteria. When bureaucrats identify beneficiaries who technically meet those criteria, but nevertheless need no assistance, they have little ability or incentive to exclude them. On the contrary, they face incentives to provide assistance to nonneedy applicants, because their careers depend on a thriving program and beneficiaries can sue the government for withholding benefits to which they are legally entitled. Taxpayers might want to cut programs that provide assistance to nonneedy applicants but lack the freedom to withdraw their "contributions" in protest, so programs that provide assistance to nonneedy applicants rarely see their funding reduced. Thus, government welfare programs tend to err on the side of subsidizing lots of people who don't need assistance.

Instances in which government appears to help too much abound.

- In 2004, budget constraints led Missouri to cut more than 100,000 people from its Medicaid rolls. Though the share of low-income children enrolled in Medicaid fell from 50 percent to 40 percent, one study found that "increases in other types of insurance coverage prevented an increase in the share that were uninsured." Before the Patient Protection and Affordable Care Act (ACA) was implemented, Medicaid-eligibility expansions in Arizona, Delaware, Maine, and Oregon did not reduce those states' uninsured rates. They were accompanied by declines in private coverage.
- A study of Medicaid expansions by ACA supporters projected "high rates of crowd-out for Medicaid expansions aimed at working adults (82 percent), suggesting that the Medicaid expansion provisions of [the ACA] will shift workers and their families from private to public insurance without reducing the number of uninsured very much."
- Economist Casey Mulligan found that the ACA creates larger disincentives to work than any law Congress has enacted in 70 years. In some cases, workers find that working more leaves them with *lower* incomes.

The most important thing that policymakers can do to help the poor obtain health insurance and medical care is adopt policies that spur cost-saving innovations and lower prices. Falling prices do not involve a Samari-

tan's dilemma. Welfare traps the poor in poverty; falling prices help them climb out. The government can help the poor most of all by reforming Medicare (see Chapter 38) and the tax treatment of health care (see Chapter 37), and by deregulating medicine (see Chapter 35) and health insurance (see Chapter 36).

In addition, federal and state governments operate three main programs to provide medical care to low-income Americans: Medicaid, the State Children's Health Insurance Program, and premium subsidies available through the Patient Protection and Affordable Care Act's health insurance "exchanges." Congress should repeal or drastically reform each of these programs.

Medicaid

Medicaid is a $578 billion program that exists ostensibly to provide health care to the poor. The federal government jointly administers Medicaid with state and territorial governments. States that wish to participate in Medicaid must pay a portion of the cost of a federally mandated set of health benefits to a federally mandated population of eligible individuals. In return, each state receives matching federal funds to administer its program. The federal treasury matches *any* amount a state spends on its Medicaid program. States receive unlimited matching funds when they make their Medicaid benefits more comprehensive or extend eligibility to more people than the federal government requires. Overall, the federal government currently finances between 63 percent and 65 percent of Medicaid spending.

All states participate in the traditional Medicaid program, which primarily serves four low-income groups: mothers and their children, the disabled, the elderly, and those needing long-term care. Specific eligibility criteria vary by state. Historically, 57 percent of traditional Medicaid funding has come from the federal government and 43 percent has come from the states.

The ACA gives states the option to expand their Medicaid programs to all adults with incomes below 138 percent of the federal poverty level ($16,394 for single adults in 2016). The principal beneficiaries are able-bodied adults. The federal government pays 100 percent of the cost of the ACA's Medicaid expansion from 2014 through 2016. The federal share then phases down to 90 percent by 2020. Thirty-one states have implemented the ACA's Medicaid expansion.

For beneficiaries, Medicaid is an entitlement. So long as they meet the eligibility criteria, they have a legally enforceable claim to benefits. People

tend to cycle on and off Medicaid for various reasons, but the Congressional Budget Office projects the average monthly enrollment for 2016 will be 77 million Americans, and the total number who will enroll at some point during the year will be 98 million.

Medicaid's Perverse Incentives

The federal government's method for distributing Medicaid funds to states encourages fraud, creates perverse incentives for state officials, and encourages states to expand their programs to people who don't need assistance. Because federal and state governments share the burden of Medicaid spending, neither side cares about the drawbacks of the program—induced dependence, waste, and fraud—as much as they should.

The more a state spends on its Medicaid program, the more it receives from the federal government. When a state spends $1, it receives between $1 and $3 from the federal government. States can thus double, triple, or even quadruple their money by spending more on Medicaid. This leads state and federal officials to tolerate stunning amounts of fraud. The Government Accountability Office consistently designates Medicaid as a "high-risk" program: official estimates of improper Medicaid payments suggest the federal share alone was $17.5 billion in 2014.

The system of matching federal funds creates perverse incentives for state officials to spend too much on Medicaid and too little on other priorities. Spending $1 on police buys $1 of police protection. Spending $1 on Medicaid, however, buys $2 to $4 of medical or long-term care. States tend to spend the marginal dollar on Medicaid even when spending it on police, education, or transportation would provide greater benefits.

The perverse incentives are even greater under the ACA's Medicaid expansion. States that want to reduce state spending by $1 million would have to cut outlays in the "old" Medicaid program by anywhere from $2 million to $5 million. (The additional savings revert to the federal government.) By contrast, since states pay only 10 percent of the cost of the Medicaid expansion, states must cut Medicaid-expansion outlays by $10 million in order to achieve $1 million of budgetary savings. In other words, the Medicaid expansion creates perverse incentives for states to cut health care spending on needier individuals rather than less-needy individuals. Cutting health care for able-bodied adults requires state officials to inflict up to five times more political pain than cutting health care for needier, more-vulnerable enrollees.

Medicaid both pulls and pushes enrollees into dependence. Medicaid makes private health care less affordable—thus pushing people into the program. Economists Mark Duggan and Fiona Scott Morton found that Medicaid's system of setting drug prices increases prices for private payers by 13 percent. The more federal and state governments expand Medicaid, the more expensive private medical care and insurance become.

Medicaid, historically, has paid health care providers directly, on a fee-for-service basis. However, states often contract with private insurers to provide Medicaid benefits to enrollees in the hope of making the program more efficient. Currently some 60 percent of enrollees receive Medicaid benefits through private insurers. This practice creates some of the same problems as in Medicare (see Chapter 38). Once states determine how much they will pay insurers per enrollee, insurers identify and recruit Medicaid-eligible individuals who will cost them less than that amount—pulling them into the system. These are often healthy people who were eligible for Medicaid but never enrolled. Whatever unnecessary expenditures these "private" Medicaid plans might avoid, the added costs of new enrollees swamp those savings. One study found that when California decided to "switch from fee-for-service to managed care," there was "a substantial increase in government spending but no corresponding improvement in infant health outcomes. The findings cast doubt on the hypothesis that health maintenance organization (HMO) contracting has reduced the strain on government budgets." Overall, contracting with private carriers tends not to reduce Medicaid spending in the average state.

The State Children's Health Insurance Program

Congress created the State Children's Health Insurance Program in 1997 to expand health insurance coverage among children in families that earn too much to be eligible for Medicaid. The federal government funds each state's program much as it funds traditional Medicaid, but with two main differences. First, states receive a larger federal match under SCHIP than under traditional Medicaid. In 2017, the federal government will pay for at least 88 percent of the cost of each state's program because the ACA authorized a temporary increase in the federal share. For every dollar that states invest in SCHIP, they can "pull down" at least $7 from the federal government (i.e., from taxpayers in other states).

Second, the federal government ostensibly limits the amount it will contribute to each state's program. But the cap is not as binding as it appears. States often burn through their federal SCHIP funds before the

end of the fiscal year and then demand additional funds. In effect, states create an emergency situation, daring Congress to throw sick children off the SCHIP rolls. Congress has repeatedly bailed out such states, effectively rewarding them for committing to spend more federal dollars than federal law allows.

As a result of these perverse incentives, states have expanded SCHIP eligibility dramatically. Nineteen states offer SCHIP to families of four with incomes of $73,000 or more. In New York, SCHIP is available to families of four earning $98,000 annually. Because SCHIP targets families higher up the income scale than Medicaid does, and because higher-income families are more likely to have health insurance to begin with, SCHIP leads to even greater "crowd-out" of private insurance than Medicaid.

Are Medicaid and SCHIP Even Helping?

Remarkably, there is little reliable evidence that these programs have a net positive effect on health, and absolutely no evidence they are the best way to improve the health of targeted populations.

Critics argue that despite the expense, Medicaid is lousy coverage. The Government Accountability Office reports that, compared with privately insured individuals, Medicaid enrollees notoriously have "greater difficulty accessing specialty and dental care," and "over two-thirds of children in Medicaid with a potential mental health need did not receive mental health services."

A study by John Bates Clark Medal-winning economist Amy Finkelstein and other top health economists examined the effects of Oregon's decision to expand Medicaid in 2008. The Oregon Health Insurance Experiment randomly assigned applicants to receive Medicaid or nothing, and then compared outcomes for the two groups. As it happens, the study's participants were drawn from the same vulnerable population targeted by the ACA's Medicaid expansion. Random assignment made this experiment the most reliable study ever conducted on the effects of health insurance. The authors found that "Medicaid coverage generated no significant improvements in measured physical health outcomes in the first 2 years, but it did increase use of health care services, raise rates of diabetes detection and management, lower rates of depression, and reduce financial strain."

The authors chose measures of physical health that should have been amenable to treatment over a two-year period. Yet Medicaid produced no improvement in the people it served compared with the people who

got no coverage. Like Finkelstein's study that found no effect of Medicare on elderly mortality in that program's first decade (see Chapter 38), the lack of any improvement in physical health outcomes among Medicaid enrollees should throw a stop sign in front of Medicaid generally and the ACA's Medicaid expansion in particular.

Similarly, there is no evidence that Medicaid is cost effective. The Oregon Health Insurance Experiment did find small improvements in self-reported mental health. But not even that study attempted to quantify whether Medicaid is a cost-effective way of achieving those gains—that is, whether state and federal governments could have purchased better health by spending those funds differently.

Whether or not Medicaid, SCHIP, or the ACA's premium subsidies turn out to improve health for some populations, or to be a cost-effective way of doing so, these programs become increasingly less cost effective the higher up the income scale they reach. Higher-income households have higher baseline access to health insurance and medical care. As these programs move up the income scale, they offer taxpayer-financed coverage to increasing numbers of people who already had private insurance. The 82 percent crowd-out estimate mentioned previously suggests the ACA's Medicaid expansion could be covering fewer than 2 previously uninsured Americans for the price of 10.

Federal and state governments should not continue to take trillions of dollars from taxpayers to support these programs when they don't even know what they are buying.

Investigate Whether Medicaid Is Actually Helping

Rather than expand Medicaid, federal and state policymakers should conduct further experiments to determine what benefits Medicaid and SCHIP actually produce and whether other uses of those funds would produce greater gains in health and financial security. Policymakers should model these studies on the Oregon Health Insurance Experiment. The studies should be conducted with existing populations rather than new enrollees, so as not to impose additional burdens on taxpayers.

States should apply for waivers from the federal government to conduct such studies. Where federal law does not provide authority for the Secretary of Health and Human Services to approve such waivers, Congress should create such authority or enact legislation directly approving such studies.

Critics will object to randomly assigning some Medicaid enrollees to receive no coverage. Such criticism makes the mistake of assuming that

Medicaid improves health when that is exactly what we do not know and precisely why states need to conduct such studies. It is unethical to preserve or expand Medicaid without knowing whether it even helps its presumed beneficiaries. The ethical course is to determine whether Medicaid is cost effective. That requires random assignment.

Refuse the ACA's Medicaid Expansion

States that have implemented the Medicaid expansion are buckling under the expense. The program is costing states far more than they or the federal government projected. In 2015, the cost was $6,366 per enrollee, nearly 50 percent more than the federal government projected. The cost to states will be even higher because enrollment in implementing states has exceeded projections by an average 91 percent. Enrollment has even exceeded *maximum*-enrollment projections by an average 73 percent.

The 19 states that dodged those bullets by refusing to implement the Medicaid expansion should continue to refuse. The 31 states that have implemented it should withdraw from the program.

Repeal the ACA

Without reliable evidence of cost-effectiveness, neither those 31 states nor Congress can justify the Medicaid expansion, particularly when every penny Congress spends on it adds to the federal debt. Congress should repeal the ACA's Medicaid expansion along with the rest of that act. Repealing the Medicaid expansion alone would reduce federal spending and deficits by $969 billion from 2017 through 2026 and eliminate the low-wage trap that the program creates. Repealing the remainder of the ACA would eliminate the low-wage traps its exchange subsidies create, while reducing the cost of private health insurance for the vast majority of enrollees of those programs. (See Chapter 36.)

The ACA remains an unpopular law. Nineteen states have rejected its Medicaid expansion. Those states have reduced federal spending, federal deficits, and the future tax burden of taxpayers in *all* states. Projections by the Urban Institute indicate that those 19 states will save taxpayers $349 billion by 2022. It is unfair to force taxpayers in states that have rejected the Medicaid expansion to pay for the expansion in the other states.

Reform Medicaid and SCHIP

Repealing the ACA is not enough, however. It makes little sense for taxpayers to send money to Washington, only for Congress to send those

funds back to their state capitols with strings and perverse incentives attached. Congress should devolve control over Medicaid and SCHIP to the states.

In 1996, Congress eliminated the federal entitlement to a welfare check, placed a five-year limit on cash assistance, and froze federal spending on such assistance. It then distributed those funds to the states in the form of block grants with fewer federal restrictions. The results were unquestionably positive. Welfare rolls were cut in half, and poverty reached the lowest point in a generation.

The federal government should emulate that success by eliminating all federal entitlements to Medicaid and SCHIP benefits, freezing federal Medicaid and SCHIP spending at current levels, and distributing those funds to the states as unrestricted block grants. Congressional Budget Office projections indicate that simply freezing federal Medicaid and SCHIP spending at 2016 levels would produce $945 billion in savings and deficit reduction by 2026. Together with repeal of the ACA's Medicaid expansion, block grants would reduce projected federal deficits from 2017 through 2026 by roughly 20 percent.

With full flexibility and full responsibility for the marginal Medicaid dollar, states could then decide whether and how to navigate the Samaritan's dilemma. States that want to focus only on their neediest residents could do so and put the savings toward other priorities like police or tax reduction. States that want to spend more on their Medicaid programs would be free to raise taxes to do so, and vice versa, without federal strictures. States would learn from the successes and failures of each other's experiments. Since states would bear the full marginal cost of their reformed Medicaid programs or successor programs, they would be more likely to conduct randomized, controlled experiments to determine the most cost-effective uses of those funds.

As an alternative to the current system of matching grants, some members of Congress have proposed that the federal government contribute to each state's Medicaid program through “per capita block grants.” In that case, the federal government would provide states with a fixed amount of funds per Medicaid enrollee. Per capita block grants would eliminate the incentive that the current matching-grant system creates for states to offer more benefits to enrollees. Indeed, they could encourage states to offer less coverage and even worse access to providers. Unfortunately, this proposal would not encourage states to remove from their Medicaid rolls people who could obtain coverage on their own. On the contrary, it would

preserve the current incentive for states to add more and more nonneedy people to their Medicaid rolls.

Block grants like those used in welfare reform would eliminate the perverse incentives that induce dependence, favor Medicaid and SCHIP spending over other priorities, lead states to tolerate widespread fraud, and encourage states themselves to defraud federal taxpayers. Over time, the federal government should give the states full responsibility for Medicaid by eliminating federal Medicaid spending while concomitantly cutting federal taxes. States can hasten these reforms by pressuring the federal government for maximum flexibility in administering their Medicaid programs.

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—Prepared by Michael F. Cannon

Entitlement Reform

40. Social Security

Congress should

- restore Social Security to long-term sustainable solvency; and
- allow younger workers to privately invest a portion of their Social Security payroll taxes through individual accounts.

Although few political candidates wanted to discuss it, the Social Security system faces severe financial pressures. Social Security's long-term unfunded liabilities now total $32.1 trillion. Congress's failure to act is threatening America's economic stability and promises to bury our children and grandchildren under a mountain of debt. Reform is not an option, it is a necessity, and Congress should act now.

But all Social Security reforms are not equal. Raising taxes and cutting benefits would have their own economic costs and would make a bad deal even worse for today's younger workers. However, by allowing younger workers to privately invest their Social Security taxes through individual accounts, we can

- help restore Social Security to long-term solvency, without massive tax increases;
- provide workers with higher benefits than Social Security would otherwise be able to pay;
- create a system that treats women, minorities, and young people more fairly;
- increase national savings and economic growth;
- allow low-income workers to accumulate real, inheritable wealth for the first time in their lives; and
- give workers ownership and control over their retirement funds.

Table 40.1
PAYGO Social Security System

Generation	Period 1	Period 2	Period 3	Period 4
0	Retired **benefits**	Dead	Dead	Dead
1	↑ Working ↑ **contributions**	Retired **benefits**	Dead	Dead
2	Unborn	↑ Working ↑ **contributions**	Retired **benefits**	Dead
3	Unborn	Unborn	↑ Working ↑ **contributions**	Retired **benefits**
4	Unborn	Unborn	Unborn	↑ Working ↑ **contributions**

SOURCE: Thomas Siems, "Reengineering Social Security for the New Economy," Cato Institute Social Security Paper no. 22, January 23, 2001.

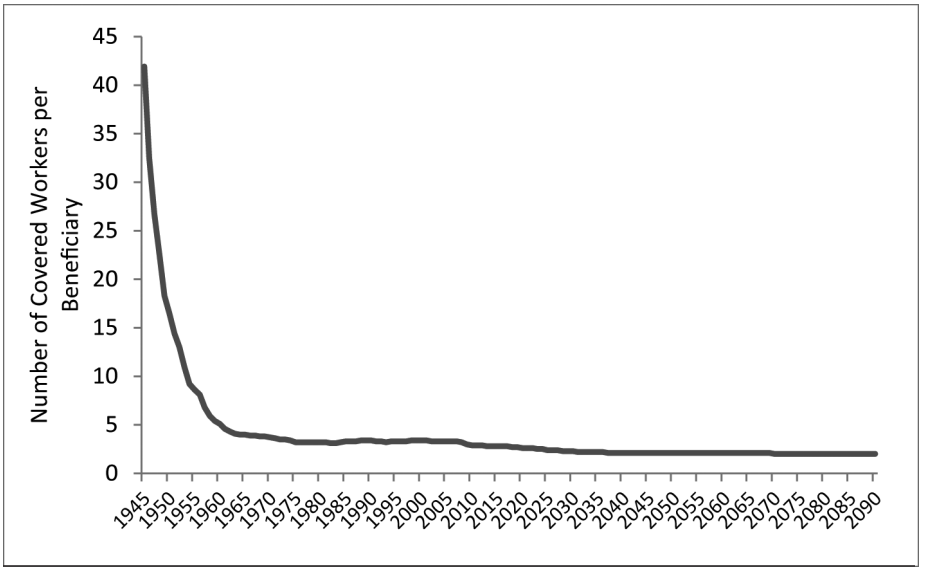
The Looming Crisis

Social Security is a "pay-as-you-go" (PAYGO) program, in which Social Security taxes are used to immediately pay benefits for current retirees. It is not a "funded plan," in which contributions are collected and invested in financial assets and then liquidated and converted into a pension at retirement. Rather, it is a simple wealth transfer from current workers to current retirees.

Table 40.1 shows a basic model of overlapping generations: people are born in every time period, live for two periods (the first as workers, the second as retirees), and finally die. As time passes, older generations are replaced by younger generations. The columns represent successive time periods, and the rows represent successive generations. Each generation is labeled by the period of its birth, so that Generation 1 is born in Period 1, and so on. In each period, two generations overlap, with younger workers coexisting with older retirees.

In Table 40.1, a PAYGO pension system provides a start-up bonus to Generation 0 retirees by taking contributions from Generation 1 workers to pay benefits to those already retired. Thus, Generation 0 retirees receive a windfall because they never paid taxes into the system. Subsequent generations both pay taxes and receive benefits. There is no direct relationship between taxes paid and benefits received.

Figure 40.1
Worker to Beneficiary Ratio, 1945–2090

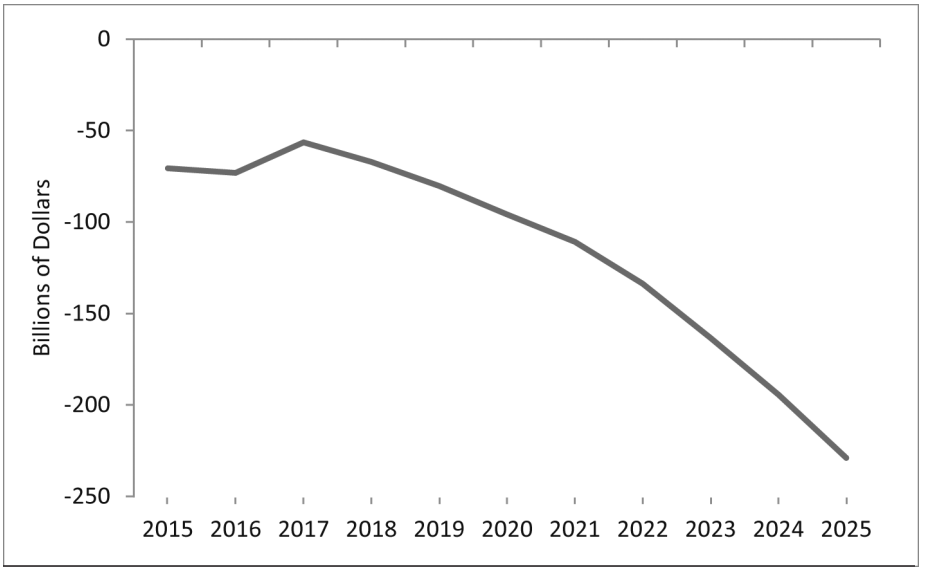


SOURCE: Social Security Administration, "The 2016 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds," Table IV.B3, Covered Workers and Beneficiaries, Calendar Years 1945–2090. Washington: Government Printing Office, 2016.

As long as the wage base supporting Social Security grows faster than the number of recipients, the program can continue to pay higher benefits to those recipients. But the growth in the labor force has slowed dramatically. In 1950, for example, there were 16.5 covered workers for every retiree receiving benefits from the program. Since then, Americans have been living longer and having fewer babies. As a result, there are now just 2.8 covered workers per beneficiary; and by 2034, there will be only 2.2 (Figure 40.1). Real wage growth (especially in wages below the payroll tax cap) has not been nearly fast enough to offset this demographic shift.

As Figure 40.2 shows, Social Security is already running a cash-flow deficit. In 2016, for instance, the program will pay out roughly $70 billion more in benefits than it takes in through taxes. That might seem a small amount of money in a world of trillion-dollar deficits, but without reform this shortfall will continue to grow. Very soon Social Security's deficit will reach levels that threaten to explode our overall budget deficit. Along with Medicare and Medicaid, Social Security will be one of the major drivers of our country's long-term debt.

Figure 40.2
Cash Flow Deficit, 2015–2025



SOURCE: Social Security Administration, "The 2016 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds," Table IV.A3, Operations of the Combined OASI and DI Trust Funds, Calendar Years 2011–2025. Washington: Government Printing Office, 2016.

NOTE: OASI = Old-Age and Survivors Insurance; DI = Disability Insurance. Intermediate scenario for years 2016–2025: payroll tax contributions and taxation of benefits are included, while net interest income is not.

In theory, of course, Social Security is supposed to continue paying benefits by drawing on the Social Security Trust Fund until 2034, after which the Trust Fund will be exhausted. At that point, *by law,* Social Security benefits will have to be cut by approximately 21 percent.

In reality, the Social Security Trust Fund is not an asset that can be used to pay benefits. Perhaps the best description of the Trust Fund can be found in the Clinton administration's fiscal year 2000 budget:

> These [Trust Fund] balances are available to finance future benefit payments and other Trust Fund expenditures—but only in a bookkeeping sense. . . . They do not consist of real economic assets that can be drawn down in the future to fund benefits. Instead, they are claims on the Treasury that, when redeemed, will have to be financed by raising taxes, borrowing from the public, or reducing benefits or other expenditures. The existence of large Trust Fund balances, therefore, does not, by itself, have any impact on the Government's ability to pay benefits.

Even if Congress can find a way to redeem the bonds, the Trust Fund surplus will be completely exhausted by 2034. At that point, Social Security will have to rely solely on revenue from the payroll tax—but that revenue will not be sufficient to pay all promised benefits. Overall, Social Security faces unfunded liabilities of $32.1 trillion over the infinite horizon. Clearly, Social Security is not sustainable in its current form. That means that Congress will again be forced to resort to raising taxes and/or cutting benefits to enable the program to stumble along.

In fact, the Social Security statement mailed to workers contains this caveat:

> Your estimated benefits are based on current law. Congress has made changes to the law in the past and can do so at any time. The law governing benefit amounts may change because, by 2034, the payroll taxes collected will be enough to pay only about 79 percent of scheduled benefits.

Other Issues with Social Security

Social Security taxes are already so high, relative to benefits, that Social Security has quite simply become a bad deal for younger workers, providing a poor, below-market rate of return. This poor rate of return means that many young workers' retirement benefits will be far lower than if they were able to invest those funds privately.

In addition, Social Security taxes displace private savings options, resulting in a large net loss of national savings, reducing capital investment, wages, national income, and economic growth. Moreover, by increasing the cost of hiring workers, the payroll tax substantially reduces wages, employment, and economic growth as well.

After all the economic analysis, however, perhaps the single most important reason for transforming Social Security into a system of individual accounts is that it would give American workers true ownership of and control over their retirement benefits.

Many Americans believe that Social Security is an "earned right." That is, because they have paid Social Security taxes, they are entitled to receive Social Security benefits. The government encourages this belief by referring to Social Security taxes as "contributions," as in the Federal Insurance Contributions Act (FICA). However, in the case of *Flemming v. Nestor*, the U.S. Supreme Court ruled that workers have no legally binding contractual or property right to their Social Security benefits and those benefits can be changed, cut, or even taken away at any time.

As the Court stated, "To engraft upon Social Security a concept of `accrued property rights' would deprive it of the flexibility and boldness in adjustment to ever changing conditions which it demands." That decision built on a previous case, *Helvering v. Davis*, in which the Court had ruled that Social Security is not a contributory insurance program, stating that "the proceeds of both the employer and employee taxes are to be paid into the Treasury like any other internal revenue generally, and are not earmarked in any way."

In effect, Social Security turns older Americans into supplicants, dependent on the political process for their retirement benefits. If they work hard, play by the rules, and pay Social Security taxes their entire lives, they earn the privilege of going hat in hand to the government and hoping that politicians decide to give them some money for retirement.

Options for Reform

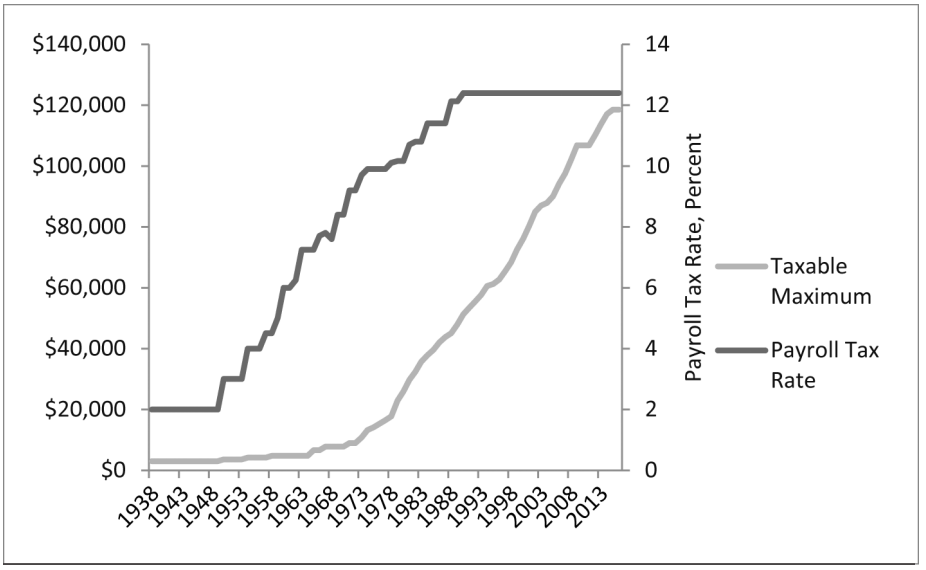
There are few options for dealing with the problem. This is not an opinion shared only by supporters of individual accounts. As former president Bill Clinton pointed out, the only ways to keep Social Security solvent are to

1. raise taxes;
2. cut benefits; or
3. get a higher rate of return through private capital investment.

Certainly, throughout its history, Social Security taxes have been raised frequently to keep the system financially viable. The initial Social Security tax was 2 percent (split between the employer and employee), capped at $3,000 of earnings. That made for a maximum tax of $60. Since then, as Figure 40.3 shows, the payroll tax rate and the ceiling at which wages are subject to the tax have been raised a combined total of 67 times. Today, the tax is 12.4 percent, capped at $118,500, for a maximum tax of $14,694. Even adjusting for inflation, that represents more than an 800 percent increase.

Alternatively, Congress can reduce Social Security benefits. Restoring the program to solvency would require an immediate 16 percent cut to benefits. If reform is delayed until, say, 2034, the required cut would grow to 23 percent. Suggested changes include raising the retirement age further, trimming cost-of-living adjustments, means testing, or changing the wage-price indexing formula.

Figure 40.3
Payroll Tax Rate and Taxable Maximum Increases, 1938–2013



SOURCE: Social Security Administration.

Obviously, there are better and worse ways to make these changes. But, as described above, most younger workers will receive returns far below those provided by private investment. Some will actually receive less in benefits than they pay into the system, a negative return. Both tax hikes and benefit reductions further reduce the return that workers can expect on their contributions (taxes).

Perhaps the best way to reduce Social Security benefits would be to change the formula used to calculate the initial benefit so that benefits are indexed to price inflation rather than national wage growth. Since wages tend to grow at a rate roughly one-percentage point faster than prices, such a change would hold future Social Security benefits constant in real terms but would eliminate the benefit escalation that is built into the current formula. The Congressional Budget Office estimates that this change would reduce scheduled outlays by 7 percent in 2040 and 40 percent by 2080. This reform would result in the largest reduction in the actuarial shortfall of any options that the Congressional Budget Office analyzed, representing an 80 percent improvement. Variations on this approach would apply the formula change only to higher-income seniors, preserving the current wage-indexed formula for low-income seniors.

Table 40.2
Funded Social Security System

Generation	Period 1	Period 2	Period 3	Period 4
0	Retired	Dead	Dead	Dead
1	Working → **contributions**	Retired **benefits**	Dead	Dead
2	Unborn	Working → **contributions**	Retired **benefits**	Dead
3	Unborn	Unborn	Working → **contributions**	Retired **benefits**
4	Unborn	Unborn	Unborn	Working → **contributions**

SOURCE: Thomas Siems, "Reengineering Social Security for the New Economy," Cato Institute Social Security Paper no. 22, January 23, 2001.

Better Reform: Personal Accounts

Ultimately, benefit reductions or tax increases are the only ways to restore Social Security to permanent sustainable solvency. But Social Security taxes are already so high, relative to benefits, that Social Security has quite simply become a bad deal for younger workers, providing a low, below-market rate of return. It makes sense, therefore, to combine any reduction in government-provided benefits with an option for younger workers to save and invest a portion of their Social Security taxes through individual accounts.

Table 40.2 shows what that would mean. Unlike the current Social Security system, each working generation's contributions actually would be saved and would accumulate as time passes. The accumulated funds, including the returns earned through real investment, would then be used to pay that generation's benefits when they retire. Under a funded system, there would be no transfer from current workers to current retirees. Each generation pays for its own retirement.

In a funded system, there is a direct link between contributions and benefits. Each generation receives benefits equal to its contribution plus the returns the investments earn. And because real investment takes place and the rate of return on capital investment can be expected to exceed the growth in wages, workers can expect to receive higher returns than under the current system.

Moving to a system of individual accounts would allow workers to take advantage of the potentially higher returns available from capital

investment. In a dynamically efficient economy, the return on capital will exceed the rate of return on labor and therefore will be higher than the benefits that Social Security can afford to pay. In the United States, the return on capital has generally run about 2.5 percentage points higher than the return on labor.

True, capital markets are both risky and volatile. But private capital investment remains remarkably safe over the long term. For example, a 2012 Cato Institute study looked at a worker retiring in 2011, near the nadir of the stock market's recession-era decline. If that worker had been allowed to invest the employee half of the Social Security payroll tax over his working lifetime, he would have retired with *more* income than if he relied on Social Security. Indeed, even in the worst-case scenario, a low-wage worker who invested entirely in bonds, the benefits from private investment would equal those from traditional Social Security. While there are limits and caveats to this type of analysis, it clearly shows that the argument that private investment is too risky compared with Social Security does not hold up.

Low-income workers would be among the biggest winners under a system of privately invested individual accounts. Private investment would pay low-income workers significantly higher benefits than can be paid by Social Security. And that does not take into account the fact that blacks, other minorities, and the poor have below-average life expectancies. As a result, they tend to live fewer years in retirement and collect less in Social Security benefits than do whites. In a system of individual accounts, they would each retain control over the funds paid in and could pay themselves higher benefits over their fewer retirement years, or leave more to their children or other heirs.

The higher returns and benefits of a private, invested system would be most important to low-income families, as they most need the extra funds. The funds saved in the individual retirement accounts, which could be left to the children of the poor, would also greatly help families break out of the cycle of poverty. Similarly, the improved economic growth, higher wages, and increased jobs that would result from an investment-based Social Security system would be most important to the poor. Without reform, low-income workers will be hurt the most by the higher taxes or reduced benefits that will be necessary if we continue on our current course.

In addition, with average- and low-wage workers accumulating large sums in their own investment accounts, the distribution of wealth throughout society would become far broader than it is today. No policy proposed

in recent years would do more to expand capital ownership than allowing younger workers to invest a portion of their Social Security taxes through personal accounts. Even the lowest-paid American worker would benefit from capital investment.

Cato's Social Security Plan

- Individuals will be able to privately invest **6.2 percentage points** of their payroll tax in individual accounts. Those who choose to do so will forfeit all future accrual of Social Security benefits.
- Individuals who choose individual accounts will receive **a recognition bond** based on past contributions to Social Security. The zero coupon bonds will be offered to all workers who have contributed to Social Security, regardless of how long they have been in the system, but will be offered on a discounted basis.
- **Allowable investment options** for the individual accounts will be based on a three-tier system: a centralized, pooled collection and holding point; a limited series of investment options, with a life-cycle fund as a default mechanism; and a wider range of investment options for individuals who accumulate a minimum level in their accounts.
- At retirement, individuals will be given the **option of purchasing a family annuity or taking a programmed withdrawal.** The two options will be mandated only to the level needed to provide an income above a certain minimum. Funds in excess of the amount required to achieve that minimum level of retirement income can be withdrawn in a lump sum.
- Individuals who accumulate sufficient funds within their account to allow them to purchase an annuity that will keep them above a minimum income level in retirement will be **able to opt out** of the Social Security system in its entirety.
- **The remaining 6.2 percentage points of payroll taxes** will be used to pay transition costs and to fund disability and survivors benefits. Once, far in the future, transition costs are fully paid for, this portion of the payroll tax will be

(continued on next page)

(continued)

reduced to the level necessary to pay survivors and disability benefits.

- The Social Security system will be **restored to a solvent pay-as-you-go program** before individual accounts are developed and implemented. Workers who choose to remain in the traditional Social Security system will receive whatever level of benefits Social Security can pay with existing Trust Fund levels. The best method for restoring the system's solvency is to change the initial benefit formula from wage indexing to price indexing.

Conclusion

Social Security is not sustainable without reform. Simply put, it cannot pay promised future benefits with current levels of taxation. Every year that we delay reforming the system increases the size of Social Security's shortfall and makes the inevitable changes more painful.

Raising taxes or cutting benefits will only make a bad deal worse. At the same time, workers have no ownership of their benefits, and Social Security benefits are not inheritable. That reality is particularly problematic for low-wage workers and minorities. Perhaps most important, the current Social Security system gives workers no choice or control over their financial future.

It is long past time for Congress to act.

Suggested Readings

Gokhale, Jagadeesh. *Social Security: A Fresh Look at Policy Alternatives*. Chicago, IL: University of Chicago Press, 2010.

Miron, Jeffrey. *Fiscal Imbalance: A Primer*. Washington: Cato Institute, 2015.

Pinera, Jose. "Empowering Workers: The Privatization of Social Security in Chile." *Cato's Letters* no. 10, May 1996.

Tanner, Michael. "The 6.2 Percent Solution: A Plan for Reforming Social Security." Cato Institute Social Security Paper no. 32, February 17, 2004.

———. *Going for Broke*. Washington: Cato Institute, 2015.

———. "Social Security, Ponzi Schemes, and the Need for Reform." Cato Institute Policy Analysis no. 689, November 17, 2011.

———. "Still a Better Deal: Private Investment vs. Social Security." Cato Institute Policy Analysis no. 692, February 13, 2012.

Tanner, Michael, ed. *Social Security and Its Discontents: Perspectives on Choice*. Washington: Cato Institute, 2004.

—Prepared by Michael Tanner

41. Poverty and Welfare

Congress should

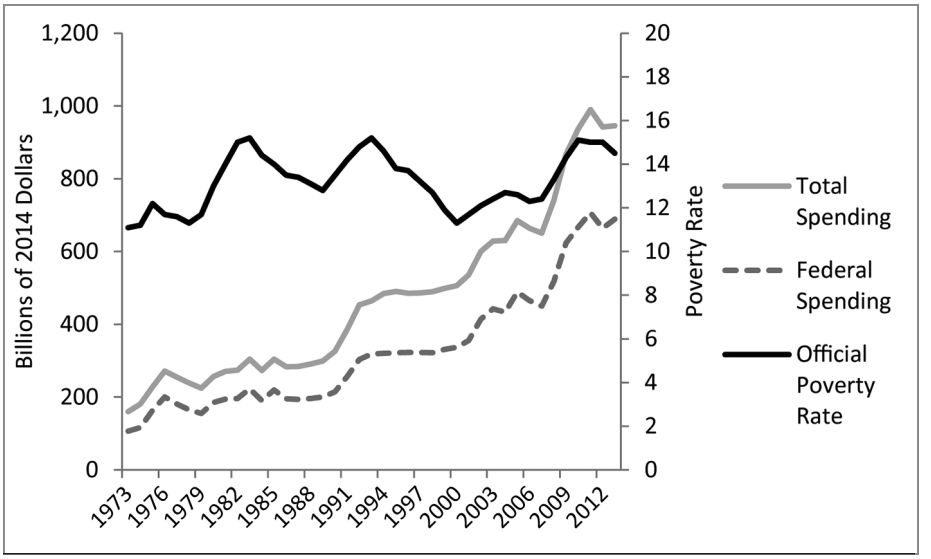
- consolidate current welfare and anti-poverty programs;
- transition from in-kind benefits to cash grants;
- reform the earned income tax credit;
- shift programs to states with as few strings as possible; and
- emphasize metrics of success, rather than funding or enrollment.

Although the exact number fluctuates from year to year, the federal government funds more than 100 separate anti-poverty programs. Some 70 of these provide cash or in-kind benefits to individuals, while the remainder target specific groups or disadvantaged neighborhoods or communities.

There are eight different health care programs, administered by five separate agencies within the Department of Health and Human Services. Six cabinet departments and five independent agencies oversee 27 cash or general-assistance programs. All together, seven different cabinet agencies and six independent agencies administer at least one anti-poverty program. And those are just the programs specifically aimed at poverty. That doesn't include more universal social welfare programs or social insurance programs such as unemployment insurance, Medicare, or Social Security.

Altogether, the federal government spent more than $680 billion in 2014 (the last year for which compete data are available). State and local governments added about $300 billion in additional funding. Thus, government at all levels is spending roughly $1 trillion per year to fight poverty. Stretching back to 1965, when President Lyndon Johnson first declared “war on poverty,” anti-poverty spending has totaled more than $23 trillion.

Figure 41.1
Poverty Rate vs. Welfare Spending, 1973–2014

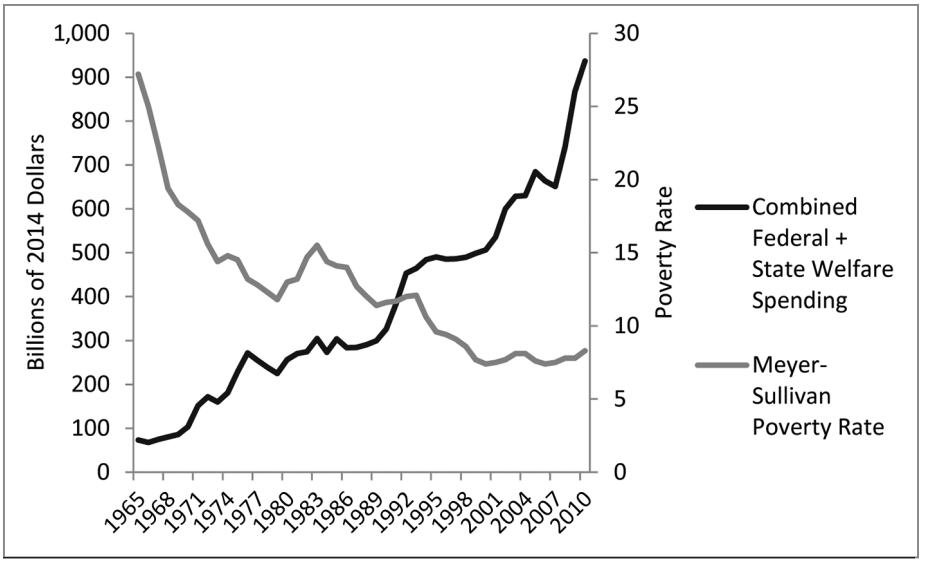


SOURCE: Bernadette D. Proctor, Jessica L. Semega, and Melissa K. Kollar, "Income and Poverty in the United States: 2015," United States Census Bureau, September 2016; Michael Tanner, "Pros and Cons of a Guaranteed National Income," Cato Institute Policy Analysis no. 773, May 12, 2015.

Yet the results of all this spending have been disappointing. Using the traditional Census Bureau definition of poverty, we have seen virtually no improvement in poverty rates since 1965. As shown in Figure 41.1, the only appreciable decline since the mid-1970s occurred in the 1990s, a time of state experimentation with tightening welfare eligibility, culminating in the passage of national welfare reform (the Personal Responsibility and Work Responsibility Act of 1996).

Most observers agree that the traditional poverty measure is badly flawed—for example, it does not count taxes or the value of in-kind benefits. But even more accurate alternative poverty measures show few gains since the mid-1970s. At the very least, marginal increases in spending appear to yield little marginal decrease in poverty or lead to any meaningful improvements in upward economic mobility. For example, a study by Bruce Meyer and James Sullivan found that the majority of improvements in a more accurate poverty measure occurred prior to 1972. Less than a third of the improvement has taken place in the past four decades, despite massive increases in expenditures during that time (Figure 41.2).

Figure 41.2
Meyer-Sullivan Poverty Rate vs. Combined Welfare Spending



SOURCE: Michael Tanner, "Pros and Cons of a Guaranteed National Income," Cato Institute Policy Analysis no. 773, May 12, 2015.

Perhaps apocryphally, Einstein is reputed to have defined insanity as doing the same thing over and over and expecting different results. Clearly, what we are doing now is not working. But much of the debate over poverty remains remarkably sterile and frozen in time. Arguing over whether we should increase or decrease spending on food stamps by another billion will do little to change the underlying dynamics of a failed system.

Many of the changes that would be most effective in reducing poverty will have to take place outside the welfare system. They include reforming the criminal justice and school systems, as well as reducing taxes and regulations to increase the availability of jobs. Those reforms are discussed elsewhere in this volume. Still, there are a number of steps that Congress can take immediately to reform our welfare system.

Simplify and Consolidate

The magnitude of the current welfare system, with its multitude of overlapping programs—often with contradictory eligibility requirements, differing rules, mixed oversight, and divided management—is a bureaucratic nightmare. The complexity and lack of transparency make it difficult

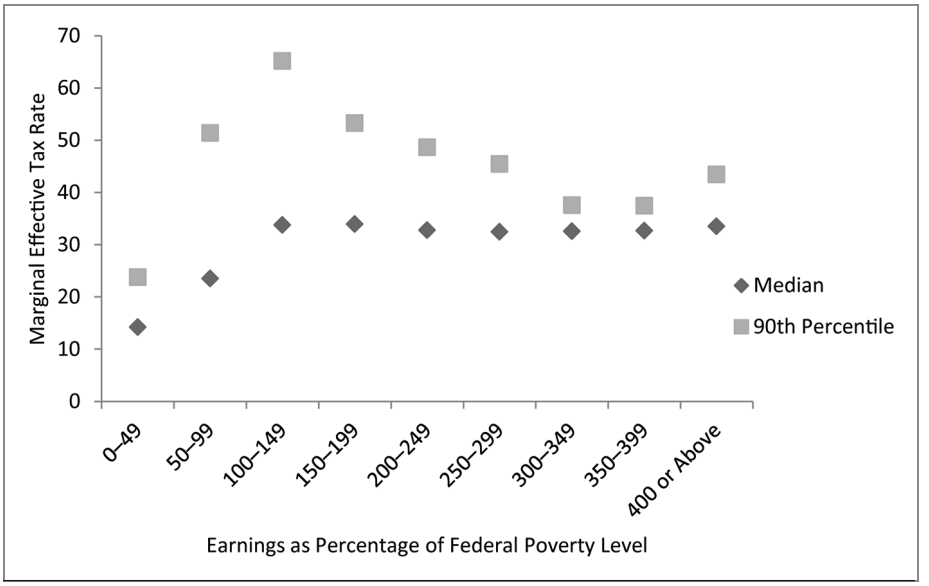
to measure whether or not programs are accomplishing their goals. Many existing programs have become little more than fiefs for special interests, providing a bureaucratic roadblock to reform. And, while the overhead and administrative costs for most programs are modest, generally under 5 percent, the costs *do* add up.

Moreover, the sheer number of programs works to suck more people into the welfare system, increasing both cost and enrollment (dependency), without necessarily targeting those efforts to the people most in need. As a result, many of the people receiving benefits are not necessarily poor, while many legitimately poor people do not receive assistance.

Some households in or near poverty that do receive assistance and participate in multiple programs can face marginal effective tax rates that are counterproductive (see Figure 41.3): they are so high that they can act as poverty traps, deterring work effort or putting a low ceiling on how much these families can increase their standard of living. In those cases, the majority of each additional dollar earned is clawed back through higher taxes or reduced benefits.

Participants in the current welfare system can find it both demeaning and difficult to navigate. Those applying for benefits must deal with

Figure 41.3
Marginal Effective Tax Rates by Family Income, 2016



SOURCE: Congressional Budget Office, "Effective Marginal Tax Rates for Low- and Moderate-Income Workers in 2016," November 19, 2015.

multiple forms, often-conflicting eligibility standards, and intrusive program administrators. Andrea Louise Campbell, an MIT professor, described the struggles of her disabled sister-in-law in her book *Trapped in America's Safety Net.* The professor notes that she found the welfare maze "incredibly complex and confusing." For more typical applicants with far less education and fewer coping skills, the process must be daunting indeed.

Receipt of benefits, therefore, often becomes a question, not of need, but of ability to game the system. Those groups and constituencies best able to maneuver through the bureaucracy are most likely to collect benefits—often multiple benefits; similarly situated individuals, or even those with greater need, who lack such skills are often left out.

There is no legitimate reason to continue to fund multiple programs that essentially do the same thing. Therefore, Congress should consolidate programs with similar functions, such as nutrition, health care, education, and so on.

Provide Cash, Not In-Kind Benefits

The vast majority of welfare benefits today are provided not in cash but rather as "in-kind" benefits. Indeed, direct cash assistance programs, including refundable tax credits, made up roughly 21 percent of federal assistance in 2015, down from roughly 29 percent a decade ago. In-kind programs—such as food stamps, housing assistance, and Medicaid—provide the poor with assistance, but only for specific purposes. In most cases, the payments are made directly to providers. The person being helped never even sees the money.

The emphasis on in-kind benefits effectively infantilizes the poor. Poor people are not expected to budget or choose among competing priorities the way people who are not on welfare are expected to. Rather, in-kind benefits substitute the government's choices, values, and priorities for those of the poor.

Virtually all programs go even further in limiting the use of benefits to government-approved purchases. For example, the Special Supplemental Nutrition Program for Women, Infants, and Children (often called "WIC") can only be used to purchase certain foods determined by government regulation. Food stamps use is being restricted to stores that stock a certain level of healthy food products, often eliminating the eligibility of small neighborhood stores. Even with cash programs like Temporary Assistance for Needy Families, state lawmakers have enacted a host of

restrictions around things like the locations where electronic benefit transfer (EBT) cards may be used to access automated teller machines (ATMs).

While it is reasonable for taxpayers, who are ultimately paying for these benefits, to seek accountability for how the funds are used, this paternalism may be both unnecessary and, worse, self-defeating. Shouldn't the poor decide for themselves how much of their income should be allocated to rent or food or education or transportation? Perhaps they may even choose to save more or invest in learning new skills that will help them earn more in the future. You can't expect people to behave responsibly if they are never given any responsibility.

Some might argue that the poor can't be trusted with money. We are told they will blow it on booze, drugs, or whatever. But that attitude is too often based on erroneous and racially biased stereotypes. There is little evidence to suggest the poor misuse their resources. For example, studies from states that drug-test welfare recipients, including Florida, suggest that the use of drugs is no higher among welfare recipients than among the general population. In fact, numerous studies have shown that even when welfare recipients are given totally unrestricted cash, they do not increase their expenditure on "temptation goods" like tobacco or alcohol.

Giving the poor responsibility for managing their own lives means giving them more choices and opportunities. That, in turn, would help break up geographic concentrations of poverty that can isolate the poor from the rest of society and reinforce the worst aspects of the poverty culture. The current welfare system not only stigmatizes the poor, increasing their isolation, but pushes them into narrowly concentrated neighborhoods clustered around subsidized housing because the system relies on providers who are willing to accept government benefits (e.g., landlords willing to take Section 8 vouchers). Those neighborhoods offer poor schools, few jobs, high crime rates, and a lack of role models. Cash would allow the poor to escape those neighborhoods the same way vouchers and tax credits allow children to escape bad schools.

And, by taking the money away from the special interests that support the welfare industry, it would break up the coalitions that inevitably push for greater spending. (For example, increased food stamp spending is inevitably backed by a coalition of liberal Democrats and farm state Republicans.)

Having consolidated welfare programs as suggested above, Congress should therefore transform as many of those programs as possible to cash grants provided directly to the poor.

Reform the Earned Income Tax Credit

One program that does provide cash directly to the poor is the earned income tax credit (EITC). Moreover, the EITC is specifically designed as a wage supplement. The EITC is tied directly to work and offsets the high marginal tax rate that many poor people encounter when they leave welfare for work. The evidence suggests that the EITC increases work effort. In particular, single mothers have seen significant labor-force gains due to the EITC.

Studies also suggest that the EITC has been more successful than other welfare programs in actually reducing poverty. The Census Bureau suggests that the poverty rate would be 2.5 percent higher in the absence of the EITC and other refundable tax credits. In fact, as measured by the additional outlays needed to lift 1 million people out of poverty (using the supplemental poverty measure), refundable tax credits such as the EITC are clearly more cost effective than other types of welfare programs.

However, as the EITC has grown, problems with the program have become more apparent. First, because the EITC focuses on families, the benefit level for childless workers is small and phases out quickly. The maximum credit available to a childless worker was only $506 in 2016, and all benefits phase out before earned income hits $14,880 (for comparison's sake, the maximum credit for a single parent with one child was $3,373). Childless workers under age 25 are not allowed to claim the EITC at all. As a result, childless adults accounted for only 3 percent of all EITC funding.

Second, as the Tax Policy Center notes, "the EITC imposes significant marriage penalties on some families. If a single parent receiving the EITC marries, the addition of the spouse's income may reduce or eliminate the credit." In some cases, if a single mother eligible for the EITC marries someone with enough earnings to bring them just above the eligibility threshold, then the entire household will no longer receive anything from EITC; if the couple decided to cohabitate and remain unmarried, then they could continue to receive some credit.

Because the credit is mostly determined by the number of children in a family, the maximum credit is the same for a single parent as it is for a married couple with the same number of children. For example, for a married couple with two children, the maximum credit is $5,572—the same as for a single filer with two children.

It is also useful to look at the breakeven points, the earned income level at which EITC benefits are exhausted. For the same two-child household, the breakeven point for a single parent is $44,648, and for married

parents it is only a little higher at $50,198. In essence, the single parent can continue to receive benefits at higher income levels relative to the poverty level than can married couples; and the credit is more generous since the benefits are being distributed among the three people, rather than four, in the household.

Third, as a refundable tax credit, the EITC is paid annually, in the manner of a tax refund. While such a lump-sum payment can certainly help many low-income families, it still leaves those families relying on low wages throughout much of the year. That is, in its current form the EITC represents an income supplement, but not a wage supplement.

Therefore, Congress should reform the EITC to turn it into a pure wage supplement. Benefits should be available to childless adults and should not rise with the number of children in a family. Payments should arrive monthly rather than in an annual lump sum. Any additional cost due to expansion should be paid for by reductions in other welfare programs.

Use the Laboratories of Democracy

Given the failure of more than 50 years of federal welfare policy to significantly reduce poverty or increase economic mobility, it should be apparent that the federal government does not know best. Nor have we demonstrated that we know enough about exactly how to reduce poverty to impose a one-size-fits-all policy everywhere in the country. Five decades of failure should have taught us to be modest.

Wherever possible, therefore, Congress should shift both the funding and operational authority for welfare and other anti-poverty programs to the 50 states. The "laboratories of democracy," as Justice Louis Brandeis described, should be the primary focus of anti-poverty efforts, not an afterthought. That means more than simply giving states the authority to tinker with programs as they exist today. It means federal funding, even in block grant form, should *not* be accompanied by a large number of federal strings. Instead, states should be given control over broad categories of funding, with the ability to shift funds freely between programs—at their discretion but within a framework in which their efforts are rigorously evaluated and they are held accountable for achieving results. Some states, for instance, may wish to emphasize job training or public service jobs. Others may feel that education provides the biggest bang for the buck. In some states, housing may be a priority; in others, the need for nutrition assistance may be greater. Some states may wish to impose strict eligibility

requirements, while others may choose to experiment with unconditional benefits, even a universal basic income.

Moreover, states that have successfully reduced poverty while also reducing the number of people on the welfare rolls, for instance, should be allowed to shift funds to other priorities entirely, such as education or transportation. Success should be rewarded. At the same time, states that fail to achieve results, after accounting for factors beyond their control, should have their funding reduced, with any shortfall made up from state funds. Failure should not be subsidized.

Good and bad examples of block granting can be seen in competing 2016 proposals by House Speaker Paul Ryan (R-WI) and Sen. Marco Rubio (R-FL). In the past, Ryan has proposed giving states a block grant in lieu of 11 current welfare programs. Unfortunately, Ryan's proposal also includes a host of strings, severely limiting the ways in which states may use the money. Rubio authored a better approach: he has called for replacing most current federal welfare programs with a single state-run "Flex Fund," under which states could provide benefits the way they want. Rubio's proposal specifically urges states to replace in-kind programs with cash benefits, although he would leave the final decision up to the states. In fact, the Rubio proposal imposes few mandates on how the states use the money. For example, while Rubio notes the importance of work requirements as a condition for receiving assistance, he would allow states to decide whether or not to impose such restrictions.

Create Standards and Metrics of Success

The lack of federal strings should not mean a lack of accountability. Too often, the federal government defines success in anti-poverty programs by looking at the inputs, such as how many people are enrolled or how much is spent, instead of measuring the effectiveness of the programs and whether they actually help the participants in their pursuit of the American dream. Anecdotes and good intentions are no substitute for evidence. Therefore, designing better outcome measures is central to the goal of making the welfare system more effective in helping people transition out of the programs and avoid becoming mired in long-term poverty.

In some programs, states have been able to utilize exemptions, credits, and other maneuvers to dilute the effectiveness of work requirements; those states end up putting fewer people on the path toward the meaningful work they need to provide for their families. In the applicable programs, shifting from a focus on caseloads to outcome measures that focus on job

placements and job retention would incentivize states to help participants move into work and get to the point they no longer need those programs.

Another aspect of refining the metrics used to evaluate implementation and administration in the states is to improve the enforcement mechanisms and better align incentives between states and the federal government. Because of the financing structure of some programs, states have an incentive to shift people to programs that are federally funded and little incentive to improve program performance for jointly funded programs in which financing is based on caseload. Congress should establish a framework that rewards states for effectively helping people transition out of the programs and penalizes them when they fall short of established program goals. Such a framework would encourage states to improve performance and reduce inefficiencies, which would save resources and better serve program recipients.

The tangled web of ineffective programs that make up the current system fails everyone involved: the programs are a waste of taxpayer dollars, and they impose real human costs on participants in the form of material hardship, unrealized potential, and dreams deferred. Without mechanisms in place to better determine whether programs are meeting their goals, more money will be channeled to efforts that could end up being unsuccessful or even counterproductive.

This problem is not confined to welfare programs. One report from the Government Accountability Office found that less than two-fifths of managers throughout the federal government reported that their programs had been evaluated in the last five years. Thoroughly evaluating these programs would help policymakers and researchers determine which programs are effectively meeting their goals. With that information, finite funding could flow to higher-quality programs while those that do not have a meaningful impact could be deemphasized. Evaluations would also help policymakers better understand the unintended adverse consequences that the current structure of the welfare system can sometimes create, such as trapping participant families in poverty.

Using rigorous evaluation and research to guide policy would allow the welfare system to adopt best practices and phase out ineffective programs. Programs that fail to deliver results would no longer continue to be funded year after year without regard for outcomes. In a framework in which states have more flexibility to innovate and tailor their anti-poverty programs to their specific populations, understanding which programs have seen positive results would be even more important.

To date, the War on Poverty has placed intentions above results, and the people most harmed by its failures are the programs' intended beneficiaries. Reforming the welfare system to better align incentives for different levels of government and the participants involved, establishing clearly defined outcome measures that ensure these programs help put people on the path to self-sufficient prosperity, and shifting to a more evidence-based approach will lead to a more effective, responsive system.

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—Prepared by Michael Tanner

42. The Earned Income Tax Credit

Congress should

- cut the EITC because it imposes a $60 billion cost on taxpayers, has a high error and fraud rate, and creates a disincentive for many workers to increase earnings; and
- enact reforms to boost market wages, such as cutting taxes on business investment.

The earned income tax credit (EITC) is a large federal aid program administered through the income tax system. Benefits are available to households with earnings from employment. In 2015, the program provided $69 billion in benefits to 28 million recipients.

The EITC is partly a tax-cut program but mainly a spending program. It is "refundable," meaning that individuals who pay no income taxes are nonetheless eligible to receive payments. About $60 billion of the benefits in 2015 were refundable.

The EITC has a high error and fraud rate, and for most recipients, it creates a disincentive to increase earnings. Also, the refundable or spending part of the EITC imposes a large cost on other people who pay the taxes to fund the benefits.

Growth of the EITC

In the 1970s, policymakers considered ways to reduce the anti-work effects of the growing welfare state. One way would have been to cut the size of the welfare state, but policymakers instead decided to expand it by enacting the EITC in 1975. Initially, the program was a 10 percent wage credit with a maximum value of $400. Only workers with children were eligible.

Over the decades, Congress expanded the size and scope of the EITC. Today, it has credit rates up to 45 percent and a maximum value of $6,269 in 2016. It provides benefits to workers with and without children.

EITC expansions in 1986, 1990, 1993, and 2009 increased the program's cost. Total benefits in constant 2015 dollars increased from $14 billion in 1990, to $45 billion in 2000, to $69 billion in 2015. The number of recipients soared from 12.5 million in 1990 to 28 million in 2015.

Structure of the EITC

EITC benefits vary depending on the number of children, income level, and filing status (single or married). Initially, the credit rises with income (the phase-in range). Then the credit reaches the maximum amount and is constant for a certain range (the flat range). Finally, the credit falls as income rises further (the phase-out range).

Consider a single parent with two children in 2016. The maximum credit would be $5,572 if the parent earned between $13,931 and $18,190. Above that, the credit would phase out and then be eliminated when earnings topped $44,648. The phase-out rate is 21.06 percent, so during the phase-out range, the parent loses $210 in EITC benefits for every additional $1,000 earned. The pattern of benefits—rising, flat, then falling—is similar for other types of families.

EITC Reduces Market Wages

The EITC is supposed to strengthen work incentives for lower-income individuals. If the EITC is successful, it should increase the labor supply of low earners. On a simple supply-and-demand diagram, the labor supply curve thus shifts to the right, which tends to reduce market wages.

A growing labor supply and falling market wages induce employers to hire additional workers. Workers who receive the EITC are better off than before with the combination of a lower market wage and the EITC. But it is interesting to note that proponents of the EITC implicitly favor cutting market wages for low earners.

One side effect of the EITC is that, to the extent it works by pushing down market wages, it hurts low earners who receive either no EITC or just a small EITC. The labor-supply effect of the EITC also means that the program acts as a subsidy to businesses that hire lower-skilled workers because they are able to pay reduced market wages.

Work Incentives and Disincentives

The EITC affects work incentives in two ways. First, it affects *labor force participation*, or the incentive for nonworkers to gain employment. Second, it affects the *number of hours worked* by people who are working. The EITC affects these factors in different ways for different people, creating both positive and negative effects.

People within the EITC's income range have an added incentive to find a job because the credit increases the reward for working. Most economists think that the EITC particularly encourages low-income single mothers to join the labor force, and there is solid empirical support for that positive effect.

However, there is doubt about the strength of this effect. EITC supporters point to gains in labor force participation among single mothers in the 1990s as evidence of the credit's benefits. The number of EITC recipients soared between 1987 and 1994 but was flat in the late 1990s. Yet from 1994 forward, participation by single mothers grew strongly. So other factors, aside from the EITC, probably caused that late-1990s increase—perhaps the strong economy at the time and welfare reforms that increased work requirements.

For workers already in the labor force, the EITC creates a mix of incentives to either increase or decrease hours worked. Workers face an "income effect," which may cause some individuals to reduce work because the EITC allows them to meet their income needs with less work. Workers also face a "substitution effect," meaning that the EITC makes working more valuable compared with not working. The substitution effect varies depending on whether individuals are in the phase-in, flat, or phase-out range of the EITC. As a result, people may respond to the credit by working either more or less at different income levels. People have an incentive to reduce hours worked in both the flat and phase-out ranges of the credit, and about three-quarters of people taking the EITC are in those two ranges. So a large majority of people taking the EITC have an incentive to work less, not more.

The EITC is only one of many government programs that alter work incentives. A study by Elaine Maag and colleagues in the *National Tax Journal* examined work incentives on a hypothetical low-income single parent with two children in each of the 50 states. As this mother's earnings rise, she pays more payroll taxes and possibly more income taxes, and she receives reduced benefits from the EITC, food stamps, and Temporary Assistance for Needy Families.

On average, across the states, the Maag study found that the parent would face a marginal tax rate of about 50 percent in moving from a poverty level of income to twice the poverty level. Adding in the effects of reduced Medicaid and Affordable Care Act subsidies further reduces incentives for people to increase their market earnings.

Errors and Fraud

The EITC has a high rate of improper payments—caused by math errors, misunderstanding of the rules, and fraud. The Internal Revenue Service reported that the EITC error and fraud rate in 2014 was 27 percent, which amounted to $18 billion in overpayments.

People are receiving excess EITC payments based on false information about such items as their income level, filing status, and qualifying children. The EITC is an easy target for dishonest filers because it is refundable, meaning that people can simply file false tax returns and wait for the Treasury to send them a check.

Part of the problem is that the EITC is complex. Benefits change as income rises, and it has multiple phase-in and phase-out rates. It is adjusted by filing status and number of children. The rules regarding child eligibility are complex due to issues such as separation and divorce. EITC rules are so complicated that two-thirds of all tax returns claiming the EITC are done by paid preparers. The credit generates so many errors that 39 percent of all IRS audits under the individual income tax are done on EITC filers.

The EITC error and fraud problems have persisted for decades, despite efforts to fix them. This is one good reason to cut or end the EITC. It is unfair to the taxpayers who fund the program for the government to misspend so much of their money year after year.

High Cost on Taxpayers

The EITC is mainly a spending program. Most payments—$60 billion a year, or 88 percent of the benefits—go to people who owe no income tax. Every dollar of those benefits is a dollar of loss for the people who pay the taxes to support the program.

Extracting those taxes to pay for the EITC damages the economy because it causes people to reduce their productive activities, such as working and investing. This economic damage is called "deadweight losses." For the federal income tax, studies have found that the deadweight loss of raising taxes by a dollar is roughly 50 cents.

Suppose that Congress expands EITC spending by $10 billion. Does the expansion make any economic sense? The benefits would have to be higher than the total cost of about $15 billion, which includes the $10 billion direct cost to taxpayers plus another $5 billion or so in deadweight losses.

EITC supporters often say that the program pulls 6 million or so people out of poverty. But that is a meaningless statistic. If the government gives low-income individuals $60 billion, of course they will have more money in their pockets, and fewer of them will be below a measured poverty line.

Why not double or triple EITC benefits and try to pull even more people out of poverty? The answer is that we need to worry about the costs of federal programs, which are the harms done to other citizens and the broader economy. Expanding the EITC would create more fraud, higher deadweight losses, and added disincentives to increase hours worked in the phase-out range.

Reform Options

The EITC should not be expanded, as some policymakers are proposing. Instead, the EITC should be cut, by reining in benefit levels and narrowing eligibility. At the same time, policymakers should pursue other policies to increase market wages and job opportunities. For example, cutting the corporate income tax rate would boost business capital investment. In turn, that would create higher demand for labor, thus generating more jobs and raising wages for all workers.

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—Prepared by Chris Edwards

Downsizing the Federal Government

43. Agricultural Policy

Congress should

- phase out farm subsidy programs because they are harmful to taxpayers, the economy, and the environment; and
- eliminate trade protections on agricultural goods while working to pursue liberalization in global markets.

The U.S. Department of Agriculture (USDA) spends $25 billion or more a year on subsidies for farm businesses. The particular amount each year depends on the market prices of crops, the level of disaster payments, and other factors. Most agricultural subsidies go to farmers of a handful of major crops, including wheat, corn, soybeans, and cotton. Roughly a million farmers and landowners receive federal subsidies, but the payments are heavily tilted toward the largest producers.

Some farm subsidy programs counter adverse fluctuations in prices, revenues, and production. Other programs subsidize farmers' conservation activities, insurance coverage, product marketing, export sales, research and development, and other activities. Agriculture is no riskier than many other industries, yet the government has created a uniquely large welfare system for farmers.

In 1996, Congress enacted some pro-market reforms under the "Freedom to Farm" law. The law allowed farmers greater flexibility in planting and moved toward reliance on market supply and demand. But Congress reversed course in the late 1990s and passed a series of supplemental farm subsidy bills. As a result, subsidies that were expected to cost $47 billion over the seven years of the 1996 law ended up costing $121 billion. In 2002, Congress enacted a farm bill that further reversed the 1996 reforms. The law increased projected subsidy payments, added new crops to the subsidy rolls, and created a new price guarantee scheme called the "counter-

cyclical" program. In 2008, Congress overrode a presidential veto to enact farm legislation that added further subsidies. The law created a permanent disaster program and added a revenue protection program for farmers to lock in profits from high commodity prices. It added a sugar-to-ethanol program to help keep sugar prices artificially high, and it added new subsidies for "specialty crops" such as fruits and vegetables.

In 2014, Congress passed yet another huge farm bill. The bill changed the structure of subsidies but did not cut the overall level of benefits. The law ended the direct payment program, the countercyclical program, and the Average Crop Revenue Election program. However, it expanded the largest farm subsidy program—crop insurance—and added two new subsidy programs, the Agricultural Risk Coverage (ARC) program and the Price Loss Coverage (PLC) program. When the 2014 farm bill was passed, supporters claimed that it would save taxpayer money, but the opposite has happened. The Congressional Budget Office now estimates that the ARC and PLC programs will cost billions of dollars a year more than originally promised. The cost of crop insurance is also rising.

All of these subsidies ensure that farm incomes are much higher than the incomes of most other Americans. Farm programs are welfare for the well-to-do, and they induce overproduction, inflate land prices, and harm the environment. They should be ended, and American farmers should stand on their own two feet in the marketplace.

Eight Types of Farm Subsidy

1. Insurance. Crop insurance run by the USDA's Risk Management Agency has become the largest farm program, with annual outlays of about $8 billion. Subsidized insurance protects against various business risks, such as adverse weather, low production, and low revenues. It covers more than 100 crops, but corn, cotton, soybeans, and wheat are the main ones. It subsidizes both insurance premiums and the administrative costs of the 19 private insurance companies that offer policies to farmers. The companies receive the subsidies and earn excess profits from the high premiums they charge; but farmers also benefit because the USDA pays about 60 percent of their premium costs, according to the Government Accountability Office (GAO). Indeed, economist Bruce Babcock finds that most farmers make money on insurance over time, receiving more in claims payouts than they pay in premiums. Congress channels the largest portion of farm subsidies through the insurance program to obscure the identities of the wealthy recipients. Under prior farm programs, news stories often

identified the millionaires receiving farm subsidies, which was embarrassing to Congress. Insurance subsidies are less transparent and have no income limits, and so Congress has expanded the program over the years.

2. Agricultural Risk Coverage (ARC). This program pays subsidies to farmers if their revenue per acre, or alternatively their county's revenue per acre, falls below a benchmark or guaranteed amount. Generally, the lower the prices and revenues are, then the larger the subsidies paid out are. More than 20 crops are covered, from wheat and corn to chickpeas and mustard. ARC subsidies fluctuate, but they were about $7 billion in 2016.

3. Price Loss Coverage (PLC). This program pays subsidies to farmers based on the average national price of each particular crop compared with the crop's reference price. The larger the fall in a crop's price below its reference price, the larger the payout to farmers. PLC subsidies also cover more than 20 crops. PLC subsidies fluctuate, but they were about $2 billion in 2016.

4. Conservation programs. The USDA runs many farm conservation programs, which cost taxpayers more than $5 billion a year. The largest is the Conservation Reserve Program, which pays farmers about $1.7 billion a year to keep millions of acres of their land out of production.

5. Marketing loans. This program was created during the New Deal. The original idea was to give farmers a loan at harvest time so that they could hold their crops to sell at a higher price later on. But the program has evolved into just another subsidy program that delivers higher payments to farmers when market prices are low. These subsidies cost about $400 million in 2016.

6. Disaster aid. The government operates various disaster aid programs for many types of farmers, from wheat growers, to livestock producers, to tree fruit producers. In addition to permanent disaster programs, Congress sometimes distributes additional aid after adverse events. Disaster and supplemental aid costs about $1 billion to $2 billion a year.

7. Marketing and export promotion. The Agriculture Marketing Service spends about $1.2 billion a year on farm and food promotion

activities. The Foreign Agricultural Service spends about $1.4 billion a year on a range of activities, including marketing U.S. farm and food products abroad through 93 foreign offices.

8. Research and other support. Most American industries fund their own research and development, but the government employs thousands of scientists and other experts to aid the agriculture industry. The USDA spends about $3 billion a year on agriculture and food research at more than 100 locations. The department also provides many other services, such as loan programs for farmers, statistical services, and economic studies.

Six Reasons to Repeal Farm Subsidies

1. Subsidies redistribute wealth upward. Farm subsidies transfer the earnings of taxpayers to well-off farm businesses and landowners. USDA data show that farm incomes have soared far above average U.S. incomes. In 2014, the average income of farm households was $134,164, which was 77 percent higher than the $75,738 average of all U.S. households. The same year, the median income of farm households was $81,637, which was 52 percent higher than the U.S. median of $53,657.

Although farm programs are advertised as support for small farmers, most subsidies go to the largest farms. Economist Vincent Smith found that the largest 15 percent of farm businesses receive more than 85 percent of all farm subsidies. Over the years, many well-known billionaires have received farm subsidies because they are the owners of farmland. Prior to the 2014 farm bill, the Environmental Working Group (EWG) found that 50 people on the Forbes 400 list of the wealthiest Americans received farm subsidies. The new farm bill channels the largest share of subsidies through insurance companies, making it hard to determine the identities of recipients. But in 2015, the GAO found that at least four recipients of crop insurance subsidies have a net worth of more than $1.5 billion.

2. Subsidies damage the economy. The extent of federal coddling and micromanagement of the agriculture industry is unique. In most industries, market prices balance supply and demand, profits steer investment, businesses take risks, and entrepreneurs innovate to improve quality and reduce costs. Those market mechanisms are blunted and undermined in U.S. agriculture, causing a range of economic harms, including overproduction, distorted land use, distorted choice of crops, inflated land prices, and inadequate cost control.

3. Subsidies are prone to scandal. Like all government subsidy programs, farm programs are subject to both bureaucratic waste and recipient fraud. One problem is that some farm subsidies are paid improperly as farmers create business structures to get around legal subsidy limits. Another problem is that Congress and the USDA distribute disaster payments in a careless manner, with payments going to farmers who do not need them. The EWG found another boondoggle: the "prevented planting" program covers losses if conditions during a season prevent farmers from planting some areas. EWG found that billions of dollars over the years have been paid to farmers who would not normally have planted the areas included in their USDA claims.

4. Subsidies undermine U.S. trade relations. Global stability and U.S. security are enhanced when less developed countries achieve economic growth. America can help by encouraging poor nations to adopt free markets and expand their international trade. However, U.S. and European farm subsidies and agricultural import barriers undermine progress on achieving open trading relationships. Federal sugar protections block freer trade within the Americas, for example, while enriching sugar growers and harming U.S. consumers and U.S. food companies that use sugar.

5. Subsidies harm the environment. Federal farm policies damage the natural environment in numerous ways. For example, subsidies cause overproduction, which draws lower-quality farmlands into active production. As a result, areas that might otherwise have been used for parks, forests, grasslands, and wetlands get locked into less efficient agricultural use. Subsidies are also thought to induce excessive use of fertilizers and pesticides. Producers on marginal lands that have poorer soils and climates tend to use more fertilizers and pesticides, which can cause water contamination problems. Sugar cane production has expanded in Florida because of the federal sugar program, for example, and the phosphorous in fertilizers used by the growers causes damage to the Everglades.

6. Agriculture would thrive without subsidies. If U.S. farm subsidies were ended and agricultural markets deregulated, farming would change. Different crops would be planted, land usage would change, and some farm businesses would contract while others would expand. But a stronger and more innovative industry would emerge with greater resilience to market fluctuations. Private insurance, other financial tools, and diversification would help cover risks, as they do in other industries.

An interesting example of farmers prospering without subsidies is New Zealand. In 1984, New Zealand ended its farm subsidies, which was a bold stroke because the country is four times more dependent on farming than is the United States. The changes were initially met with resistance, but New Zealand farm productivity, profitability, and output have soared since the reforms. New Zealand farmers cut costs, diversified land use, sought nonfarm income, and developed niche markets such as kiwi fruit. The Federated Farmers of New Zealand argues that that nation's experience "thoroughly debunked the myth that the farming sector cannot prosper without government subsidies." That myth needs to be debunked in the United States as well.

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—Prepared by Chris Edwards

44. U.S. Postal Service

Congress should

- repeal the U.S. Postal Service monopolies on first-class mail, standard mail, and access to mailboxes;
- repeal the special tax and regulatory benefits given to the Postal Service; and
- privatize the Postal Service.

The U.S. Postal Service (USPS) is a major business enterprise operated by the federal government. Revenues from the sale of USPS products are supposed to cover the company's costs. But with the rise of electronic communications, mail volume has plunged, and the 600,000-worker USPS has been losing billions of dollars a year. The USPS has a legal monopoly over various types of mail. Entrepreneurs are prevented from launching competing postal services and trying to improve quality and reduce costs for consumers. Other countries facing falling mail volumes have privatized their systems and opened them to competition. America should follow suit and liberalize its postal industry so that it can better adjust to changes in the modern Internet-based economy.

USPS Advantages

Congress confers on the USPS monopolies on the delivery of first-class mail (letters under 13 ounces) and standard mail (bulk advertising items). The agency also has a legal monopoly on access to mailboxes, which is a unique protection among postal systems in the world.

The USPS also enjoys a range of other benefits:

- It can borrow from the U.S. Treasury at subsidized interest rates.
- It is exempt from state and local sales, income, and property taxes and fees.

- It pays federal corporate income taxes, but those taxes are circulated back to the USPS.
- It is not bound by local zoning rules and has the power of eminent domain.
- It has government regulatory power, which it has used to impede competitors.

USPS Failures

Despite those advantages, the USPS has lost more than $50 billion since 2007 and will likely continue losing money without major reforms. One problem is that Congress stymies USPS efforts to improve efficiency. It blocks USPS efforts to close unneeded post office locations, blocks the consolidation of mail-processing centers, and blocks the ending of Saturday delivery. Private businesses make such operational adjustments all the time as demand for their products changes.

USPS's costly union workforce is another problem. Compensation for USPS workers is higher, on average, than for comparable private workers. Collective bargaining agreements—which cover more than four-fifths of the USPS workforce—make it more difficult for management to make cost-saving changes. In some cases, unions have resisted the automation of postal functions.

The postal system's financial challenges stem from the drop in first-class mail volume, which fell from a peak of 104 billion pieces in 2001 to 62 billion pieces in 2015, a decline of 40 percent. The decline is driven by the rise of email, Facebook, Evite, and Internet bill paying; the decline of printed magazines; and the rise of online advertising as an alternative to bulk print advertising.

The USPS's financial challenges have been compounded by a requirement passed in 2006 to pay down the company's large unfunded liabilities for retiree health care. USPS defenders complain that private companies are not required to prepay retiree health costs. But the vast majority of private firms do not even offer retiree health coverage. Also, since traditional mail faces a long-term decline, it is better to tackle those costs now than to leave them to taxpayers down the road under a possible federal bailout of the USPS.

Postal Reforms Abroad

Other nations with money-losing mail systems have either privatized them, opened them to competition, or both. Private companies have more

flexibility to deal with today's challenges. And with the rise of the Internet, the argument that mail is a natural monopoly needing special protection is weaker than ever.

The European Union (EU) has recognized these realities and pressed its member nations to deregulate their systems. Most EU countries now have a more entrepreneurial postal industry than we do. The United States ranks near the bottom of the Consumer Postal Council's 26-country "Index of Postal Freedom."

Here is a sampling of postal reforms abroad:

- Sweden in 1993 became the first major European country to repeal its postal monopoly.
- The Netherlands privatized its national postal company in 1994 and opened postal markets to competition in 2009.
- New Zealand repealed its postal monopoly in a series of laws during the 1980s and 1990s.
- Germany partly privatized Deutsche Post in 2000, and today 79 percent of the company's shares are privately owned. Germany opened postal markets to competition in 2008.
- Britain opened postal markets to competition in 2006 and privatized the Royal Mail in share offerings in 2013 and 2015.

In many countries, dominant national carriers now have some competitors, often focused on niches such as business mail or bulk mail. Some privatized companies, such as Deutsche Post, have expanded internationally. Progress toward full competition has been a slow but steady process.

Experience has shown that both privatization and competition create efficiency gains. In New Zealand and Sweden, government postal firms slashed their workforces by about one-third when they were restructured and opened to competition. Similar job cuts were prompted when Germany and the Netherlands privatized their systems.

Restructuring U.S. Postal Services

Congress should privatize the USPS, repeal its legal monopolies, and give the company the flexibility it needs to reduce costs. Those reforms would give entrepreneurs a chance to improve America's postal services. Since the USPS monopoly over "extremely urgent" mail was lifted in 1979, we have seen the growth of innovative private delivery firms such as FedEx.

Instead of privatization, some USPS supporters want the company to expand into banking, payday loans, grocery delivery, and other activities. But such expansions would only create more problems. The USPS would have to find activities where it could earn above-normal profits to funnel excess cash back to support the mail system. But it is unlikely that a government agency—if not subsidized—could out-compete private firms in other industries. Past USPS forays into nonmail areas, such as electronic bill paying, ended in failure. And if the USPS used its government advantages to undercut private firms, that would be both distortionary and unfair.

In an October 2015 study, economist Robert Shapiro found that the USPS raised prices on its monopoly products and uses those revenues to subsidize express mail and package delivery. He estimates that the cross-subsidies are $3 billion or more a year. For FedEx, United Parcel Service, and other private firms, that practice is unfair because—unlike the USPS—they have to pay taxes, borrow at market rates, and follow all the normal business rules.

The cross-subsidy problem is difficult to solve under the current postal structure because the USPS obscures its finances by attributing a large share of costs to overhead. Privatization and competition would serve to increase transparency in postal system finances and end the cross subsidies.

Policy experts are coming around to the need for major reforms. Economist Robert Atkinson proposed that the USPS focus on delivering the "final mile" to homes, while opening collection, transportation, and the processing of mail to competition. Elaine Kamarck of the Brookings Institution—like Atkinson and Shapiro, a veteran of President Bill Clinton's administration—has proposed a similar partial privatization, with the USPS continuing to provide universal service to homes.

Partial privatization would move in the right direction, but foreign reforms show that full privatization is also achievable. In Germany, Britain, and the Netherlands, the dominant private postal firms continue to provide universal service. Postal companies have a strong incentive to provide universal service because, as a network industry, the value of the service increases the more addresses that are served.

USPS supporters fear that rural areas would be left out unless the government required universal service. But Cornell University economist Richard Geddes argues that is probably not the case. Rural postal routes can be as cost-effective to serve as urban routes because rural letter carriers stay in their trucks and use roadside boxes, whereas urban letter carriers often walk their routes.

U.S. policymakers should be more flexible about how they define "universal service." For example, delivery could be reduced from six days a week to every second day. Service would still be universal, but the USPS could slash its massive fleet of 211,000 vehicles, reducing both costs and energy consumption. Other countries interpret universal service more narrowly than we do—some countries have cluster boxes for communities, some exclude bulk mail from universal service requirements, and some allow more flexibility in pricing.

All that said, a universal service obligation for paper mail is not needed in the modern economy. Electronic communications bind the country together without it. Household-to-household personal letters have plunged to just 3 percent of total mail volume today, according to USPS data. Advertising represents 60 percent of the entire household mail volume. Bills and other business statements are the second largest type of mail, but these are being replaced by electronic payments, which now account for 63 percent of all bill payments.

Essentially then, Congress currently imposes a rigid monopoly on the nation so that we can receive mainly "junk mail" in our mailboxes six days a week. But there are more than 200 billion emails blasted around the planet every day, so it makes little sense to retain special protections for the government's old-fashioned paper delivery system.

Congress should wake up to changes in technology and to postal reforms around the world. Other countries have shown that postal liberalization works, and it would work in America as well.

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—Prepared by Chris Edwards

45. Amtrak

Congress should

- privatize Amtrak and allow the passenger rail company to shed uneconomic routes and restructure its operations and labor force; and
- phase out subsidies to passenger rail and other modes of transportation.

Private passenger rail thrived in the United States between the mid-19th century and the early 20th century. By the late 1950s, however, passenger rail was struggling because of the rise of automobiles, buses, and airlines. Railroads faced large tax, regulatory, and union burdens not faced by other modes of transportation. The Interstate Commerce Commission micromanaged the railroads and hindered their efforts at cutting costs. Railroads paid heavy property taxes, and the federal government imposed a special excise tax on rail tickets from the 1940s until 1962.

After a number of railroads, including Penn Central, went bankrupt, Congress stepped in to take over passenger rail by creating Amtrak in 1970. Amtrak is structured like a corporation, but the federal government owns virtually all the company's stock. It was supposed to become self-supporting after a transition period, but it has never earned a profit and has consumed more than $40 billion in federal subsidies over four decades. In 2015, Amtrak had revenues of $3.2 billion and expenses of $4.3 billion, and it received federal subsidies of $1.4 billion.

Amtrak's Failures

Amtrak has many woes. Only about three-quarters of its trains run on time. The entire Amtrak system accounts for only a tiny fraction of

America's passenger travel. And the company's operations are so inefficient that it even loses tens of millions of dollars a year on its food service.

Amtrak has an expensive and inflexible workforce. It has about 20,000 employees, who earned an average $105,000 a year in wages and benefits in 2014, according to company financial statements. Amtrak pays a huge amount of overtime, a substantial amount of which appears to be unnecessary. More than a dozen collective bargaining agreements cover 86 percent of Amtrak's workforce. Unions undermine efficiency by protecting poorly performing workers, resisting innovation, and creating a rule-laden workplace. Former Amtrak head David Gunn complained that at Amtrak's maintenance facilities, workers from different unions were not allowed to share work on projects outside of their narrowly designated specialties.

Most of Amtrak's problems are created by Congress, which prevents the company from making rational business decisions. Congress insists on supporting an excessively large nationwide system of passenger rail. Many routes have low ridership and lose money, which does not make economic or environmental sense.

In his 2004 book, *End of the Line*, rail expert and former Amtrak spokesman Joseph Vranich argued, "Congressional requirements that Amtrak spend money on capital improvements to lightly used routes are outrageous. . . . Throughout Amtrak's history, it has devoted too much of its budget to where it is not needed, and not enough to where it is."

Amtrak operates 44 routes on 21,000 miles of track in 46 states. Amtrak owns the trains, but freight rail companies own about 95 percent of the track. A 2012 analysis by Randal O'Toole found that only four Amtrak routes earn an operational profit. Some Amtrak routes lose hundreds of dollars per passenger and fill less than 40 percent of the seats.

The few routes that earn a positive return are in the Northeast, while the biggest money losers are the long-distance routes, such as New Orleans to Los Angeles. The Government Accountability Office found that the long-distance routes account for 15 percent of Amtrak riders but 80 percent of its financial losses. In sum, Amtrak spends a lot of money maintaining high-loss routes at the expense of routes with heavier traffic.

Advantages of Privatization

Privatization of passenger rail would improve rail performance and reduce costs. A private company would have more flexibility to prune excess workers, base worker pay on performance, and end harmful union rules. It would be able to close routes that continued to lose money.

Passenger rail makes sense in the Northeast corridor between Boston and Washington, D.C., but that corridor accounts for fewer than 500 miles within the current 21,000-mile system. Other routes may also make sense within a lower-cost privatized system. A privatized Amtrak could close the least successful routes and shift investment and maintenance spending to the high-demand routes to improve service quality.

Reforms abroad show that privatizing passenger rail works. Vranich found that privatized rail systems generally provide improved service, increased ridership, and more efficient operations. In the United Kingdom, for example, he argued that "private operators have demonstrated more initiative, imagination, and visionary planning than state-run British Rail did in its prime or Amtrak does today."

When it was state owned, British Rail consumed a large amount of subsidies and faced a long-term decline in UK transportation market share. In 1994, the government split up the company and privatized the track infrastructure separately from passenger service operating companies. The ending of vertical integration in the industry created problems, and track infrastructure has been essentially renationalized. Some experts argue that vertical integration should be reintroduced.

However, passenger services have flourished since privatization. Rail ridership has more than doubled in the past two decades, from 740.0 million passenger trips to 1.5 billion, according to the UK Department of Trade and Investment. UK rail ridership is hitting levels not seen since the early 1920s, and ridership growth has far surpassed the growth elsewhere in Europe.

Despite the large increase in passengers, the on-time performance of British passenger rail improved after privatization, and surveys find solid levels of customer satisfaction today. In a 2013 study, the European Commission found that the United Kingdom's railways were the "most improved" in Europe since the 1990s.

Japan's rail privatization was also a success. In the 1980s, Japanese National Railways (JNR) was stagnating as a result of bloated labor costs, labor strife, and political manipulation. The government broke up JNR into six regional and vertically integrated passenger rail companies in 1987 and then started privatizing them in the 1990s.

The JNR companies reformed their rigid union rules and slashed their workforces by roughly one-third following the reforms. A National Bureau of Economic Research study found that labor productivity in the Japanese passenger rail companies increased, on average, by about 50 percent with

the restructuring and privatization of the 1990s. Accident rates were cut in half. Vranich called the results of JNR's privatization "stunning."

The United States has its own positive experience with rail privatization—freight rail privatization. When Penn Central collapsed in 1970, it was the largest business failure in American history to that date. Other railroads followed it into bankruptcy. Congress created Conrail in the mid-1970s to replace the failed railroads. That government-owned company consumed $8 billion in subsidies and floundered until Congress deregulated freight rail under the Staggers Rail Act of 1980. Deregulation allowed Conrail to become profitable, and it was privatized in 1987. Since then, U.S. freight railroads have been a dramatic success.

Amtrak supporters argue that since other modes of transportation receive subsidies, so should passenger rail. But Amtrak receives substantially more subsidies per passenger mile than other modes of transportation, including automobiles, buses, and aircraft. Automobiles receive relatively little in net subsidies because government highway spending is mainly covered by fuel taxes. That said, subsidies to all modes of transportation should be phased out.

The problem for passenger rail is not that it needs more subsidies, but that competitors to rail have become more efficient. For consumers, real (inflation-adjusted) rail prices have risen in recent decades, while real airline prices have fallen because of the deregulated and competitive airline environment. Real intercity bus prices have also fallen with the rise of low-cost firms such as Megabus. To tackle air and bus competition, rail needs to be moved to a similar private and deregulated environment.

It seems unlikely that passenger rail will play a large role in America's transportation future. Rail carries few people compared with automobiles and airplanes, and in many U.S. corridors, rail makes little economic sense. However, entrepreneurs could bring enough cost cutting and innovation to passenger rail to make it more competitive and financially viable. With that goal in mind, we should free passenger rail from the government and give it the flexibility it needs to compete against other modes of transportation.

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—Prepared by Chris Edwards

46. Air Traffic Control

Congress should

- move air traffic control operations from the Federal Aviation Administration to a self-funded nonprofit corporation separate from the government.

The nation's air traffic control (ATC) system is currently operated by the Federal Aviation Administration (FAA). ATC is an increasingly high-technology industry, but we are still running it as an old-fashioned bureaucracy from Washington. The FAA is an inflexible and slow-moving agency, and it has a history of cost overruns and delays on major projects.

In recent decades, many nations have partly or fully separated their ATC systems from their governments. In 1996, Canada moved its ATC to a private nonprofit corporation, Nav Canada. That reform is the model for an FAA restructuring bill that passed the House Transportation and Infrastructure Committee in 2016.

Air traffic control reform is long overdue. Moving ATC operations out of the government would improve efficiency and spur innovation. The benefits would include shorter flight times, fewer delays, and lower fuel costs.

Management and Technology Failures

The FAA has struggled to modernize America's ATC system. It relies on 20th-century technologies, such as radar and voice radio, despite the development of newer technologies, such as satellite-based navigation. In a detailed study of the FAA's performance, Robert Poole of the Reason Foundation found that the agency is risk averse, is slow to make decisions, and mismanages procurement. It loses skilled people to private industry because of a lack of pay flexibility and frustration with the government work

environment. Poole found that the FAA "is slow to embrace promising innovations" and is "particularly resistant to high-potential innovations that would disrupt its own institutional status quo." That is the opposite of what is needed in a dynamic technology-based industry.

Dorothy Robyn, a policy expert in both the Clinton and Obama administrations, examined ATC reforms in a Brookings Institution study. She concluded, "As a traditional government agency constrained by federal budget rules and micromanaged by Congress, the FAA is poorly suited to run what amounts to a capital-intensive, high-tech service business."

Robyn argues that Congress has "long blocked large-scale consolidation of the FAA's aging and inefficient facilities," and it "micromanages FAA spending on investment and maintenance." Members of Congress have intervened to save FAA jobs in their districts, and they have required the FAA to procure certain hardware.

These problems can be solved by separating ATC from direct federal control. Such a reform would solve the conflict of interest arising from the FAA both operating ATC and overseeing aviation safety. Splitting off ATC operations would increase transparency because hidden decisions now made internally within the FAA would be made public. Such a separation is recommended by the International Civil Aviation Organization.

In coming years, rising demands for air travel are expected to severely strain the FAA. Our airspace is getting more crowded, and our antiquated ATC is causing delays and wasting fuel. Transitioning to new ATC technologies would increase safety, while also raising airspace capacity and saving fuel by allowing aircraft to fly more direct routes. New technologies would also reduce the number of needed ATC facilities.

However, those benefits remain elusive because the FAA has struggled to upgrade its system. A 2012 Government Accountability Office report found that half of FAA's major acquisition programs were behind schedule. A 2016 report from the Department of Transportation's inspector general found that several critical programs "remain over budget and behind schedule due to overambitious plans, unresolved requirements, software development problems, ineffective contract management, and unreliable cost and schedule estimates." The report also found that the FAA's "total budget, operations budget, and compensation costs have doubled while operational productivity . . . has decreased substantially."

Gains from Privatization

Dozens of nations have restructured their air traffic control systems to separate them from their government budgets. Canada privatized its system

in 1996 in the form of a self-funded nonprofit corporation, Nav Canada. That reform caught the eye of House Transportation and Infrastructure Committee chairman Bill Shuster (R-PA), who introduced legislation to transfer our ATC to a similar nonprofit corporation that would have a cost-based user fee structure.

The Canadian reform has been very successful. Nav Canada has won three International Air Transport Association (IATA) Eagle Awards as the world's best ATC provider. The IATA has said that Nav Canada is a "global leader in delivering top-class performance"; its "strong track record of working closely with its customers to improve performance through regular and meaningful consultations, combined with technical and operational investments supported by extensive cost-benefit analysis, place it at the forefront of the industry's air navigation service providers."

In Canada, funding was changed from a government ticket tax to direct charges on aircraft operators for services provided. Nav Canada revenues come from charges for flying through Canadian airspace and for terminal services at airports. Those cost-based charges are a more efficient way to price ATC services than the U.S. system, which is mainly based on ticket taxes.

Nav Canada is a private monopoly, so there might be concerns that its user charges would rise excessively. But that has not happened. Indeed, Nav Canada's real customer charges have fallen by one-third over the past decade, as efficiency has increased. The system is handling 50 percent more traffic than before privatization, but with 30 percent fewer employees, noted Robyn. One reason for the good performance is that airlines and other aviation stakeholders have seats on Nav Canada's corporate board, and those stakeholders have a strong interest in increasing both efficiency and safety.

Another advantage of privatization is innovation. Nav Canada is praised for its development of new technologies. Robert Poole noted, "the technical expertise at Nav Canada has led to a thriving business marketing innovative ATC hardware and software and advising other air navigation service providers." In a 2013 address, Nav Canada's chairman Nicholas Geer said that the company has "sold and installed our home-grown technology around the world from Australia to Hong Kong to Dubai, and all over the UK and Europe."

In testimony before the Senate Commerce Committee on May 19, 2015, the head of the U.S. National Air Traffic Controllers Association (NATCA), Paul Rinaldi, described some of Canada's advantages:

> They have the air traffic controller, the engineer, and the manufacturer working together from conceptual stage all the way through to training, implementation, and deployment within their facilities. And what that does is it saves time and money. And they actually are developing probably the best equipment out there, and they are selling it around the world. And they are doing it in a 30-month to three-year time frame, when we have to look much longer down the road because of our procurement process in this country.

In 2016, the NATCA backed the Shuster bill to move our ATC into a nonprofit corporation. It may seem unusual that a labor union is supportive of such reforms, but the controllers are concerned that our system is not receiving the steady funding and advanced technology that is needed. A self-funded ATC would create more financial stability than the current system, which is buffeted by chaotic federal budget battles.

A 2009 study by Glen McDougall and Alasdair Roberts examined 10 partly or fully commercialized (or privatized) ATC systems in other nations. They looked at performance and safety data, and they interviewed users of the different systems. They found that, in general, service quality improved, safety improved, and costs were reduced in the commercialized systems.

A 2005 Government Accountability Office study looked at the performance of commercialized ATC systems in Australia, Canada, Germany, Great Britain, and New Zealand. It concluded that those systems had cut costs, invested in new technologies, and either maintained or increased safety under the reforms.

Reforms Are Long Overdue

Since the 1970s, numerous studies and commissions have recommended restructuring the U.S. air traffic control system. In the 1990s, for example, the Clinton administration proposed moving ATC from the FAA to a self-funded government corporation.

Today, the dominant reform model is the privatized Canadian system. Privatization would provide the flexibility, incentives, and funding needed for ATC managers to increase efficiency and pursue innovation. Innovation is the key to reducing flight times, increasing airspace capacity, and cutting fuel costs.

In an October 18, 2015, interview in the *Wall Street Journal*, the head of Nav Canada, John Crichton, was blunt: "This business of

ours has evolved long past the time when government should be in it. . . . Governments are not suited to run . . . dynamic, high-tech, 24-hour businesses."

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—Prepared by Chris Edwards

47. K–12 Education

Congress should

- continue down the path of returning power to states, districts, schools, and parents that has slowly begun with passage of the Every Student Succeeds Act;
- ultimately eliminate federal involvement in K–12 education except for supplying school choice in Washington, D.C., funding education for students in military families, and prohibiting discrimination in state and local provision of education; and
- via tax reductions, let taxpayers keep the roughly $80 billion per year that the federal government spends on K–12 education.

The Constitution gives the federal government no authority to exercise control over elementary and secondary education, including by spending money and attaching conditions to the funds, the primary mode by which Washington has influenced education. And no, the Founders did not exclude dominion over education from the specific, enumerated powers given to Washington because they thought such authority was subsumed under the "general welfare" clause. They did not include it because education at the time was believed best left in the hands of parents and civil society—the families and communities closest to the children—and certainly not in a distant, national government. Fifty years of experience with major and, until very recently, constantly expanding federal meddling in K–12 education has proven them right.

A Brief History of Federal Involvement

The federal government, relatively speaking, is a newcomer to elementary and secondary schooling. As many advocates of a federal role in

education are quick to point out, the Land Ordinance of 1785 and Northwest Ordinance of 1787 did contain provisions calling for territories to dedicate the revenue coming from the sale of portions of land to educational purposes. But those laws preceded the Constitution, were often ignored, and asserted no federal control over what might be taught, how, or by whom. And clearly, James Madison, one of the primary architects of the Constitution, as well as other members of Congress, did not consider education to be among the matters rightfully within the reach of the federal government. In 1792, Madison argued against a bill to provide aid to fisheries by noting that were Congress to decide that the Constitution furnished the authority to spend money on fisheries, they could also, absurdly, "take into their own hands the education of children." Indeed, as recently as 1943, the U.S. Constitution Sesquicentennial Commission, chaired by President Franklin Delano Roosevelt, published a document that included the following: "Q. Where, in the Constitution, is there mention of education? A. There is none; education is a matter reserved for the states."

Thus, federal governance of elementary and secondary education is of relatively recent vintage. A U.S. Department of Education was created in 1867, but it was downgraded to a bureau two years later and was charged mainly with collecting statistics, not governing. Not until the Soviet Union sent the satellite Sputnik into orbit in 1957, and the American public briefly panicked, did the federal government for the first time try to exercise significant influence over education. That foray, the National Defense Education Act, primarily aimed to improve capacity in science and engineering at the college level. And the act maintained a clear connection to a constitutionally explicit federal responsibility: providing for the common defense.

Only in the mid-1960s, under President Lyndon Johnson's "Great Society," did Washington completely break with the Constitution by enacting a K–12 law untethered to national defense. The Elementary and Secondary Education Act (ESEA) was enacted in 1965 and sought, primarily, to provide "compensatory" funding to districts serving low-income populations. The intent was not to exercise authority over states and districts, but to equalize resources. What was discovered over the course of about two decades, however, was that funding alone made little difference in outcomes.

By the early 1980s, many people considered the American education system to be failing. As a result, the federal role began to morph from

one focused on funding, to one focused on control—control made possible only by attaching coercive rules to federal dollars. Indeed, the Reagan administration at first strove to eliminate the cabinet-level U.S. Department of Education, which had just been re-created in 1979. But in 1983, the administration published *A Nation at Risk*, a report with a Sputnik-like effect. It intoned, "If an unfriendly foreign power had attempted to impose on America the mediocre educational performance that exists today, we might well have viewed it as an act of war." The administration's second education secretary, William Bennett, became a major personality to whom the media and public looked for guidance on education issues, and the 1988 reauthorization of the ESEA for the first time called on states and districts to demonstrate academic achievement. The era of "standards and accountability" had begun, and it arguably reached its apex with the 2002 ESEA reauthorization, the No Child Left Behind Act (NCLB).

NCLB asserted enormous control over the shape and functioning of K–12 education, requiring that all schools adhere to uniform state standards, be held accountable by aligned standardized tests, and bring all students (including numerous subsets based on race and other group identities) to full "proficiency" by the end of the 2013–2014 school year. Schools were punished if any group failed to make "adequate yearly progress" toward that full-proficiency goal.

Over time, parents and others increasingly came to dislike the law's strictures and huge emphasis on standardized tests, and irritation evolved into disgust with the "Race to the Top" program. Among other things, that program in effect required states to use the so-called Common Core national curriculum standards and to use one of just two federally funded, Common Core–aligned tests, to compete for a share of a $4 billion pool of funding. The program also called for greater data collection on students and for teacher evaluations based on students' standardized test scores. In addition, the Obama administration started to offer NCLB waivers in exchange for states adopting administration-selected policies. Those centralizing efforts united opposition on the left and right against Washington, the new "national school board."

The end result of exhaustion with federal control is the latest iteration of the ESEA, the Every Student Succeeds Act (ESSA), which President Barack Obama signed in December 2015. The ESSA is intended to remove the most onerous provisions of NCLB, Race to the Top, and NCLB waivers; those provisions include the mechanistic "adequate yearly

progress," coercion to adopt the Common Core, and use of standardized test scores in teacher evaluations. It is also supposed to eliminate much of the unilateral authority the secretary of education had under the Race to the Top and waiver systems. Still, a strong note of caution is needed: as of mid-2016, the Department of Education is drafting the ESSA regulations, and some observers are seriously concerned that the executive branch will gut the legislative intent on such matters as funding equity and measuring academic performance.

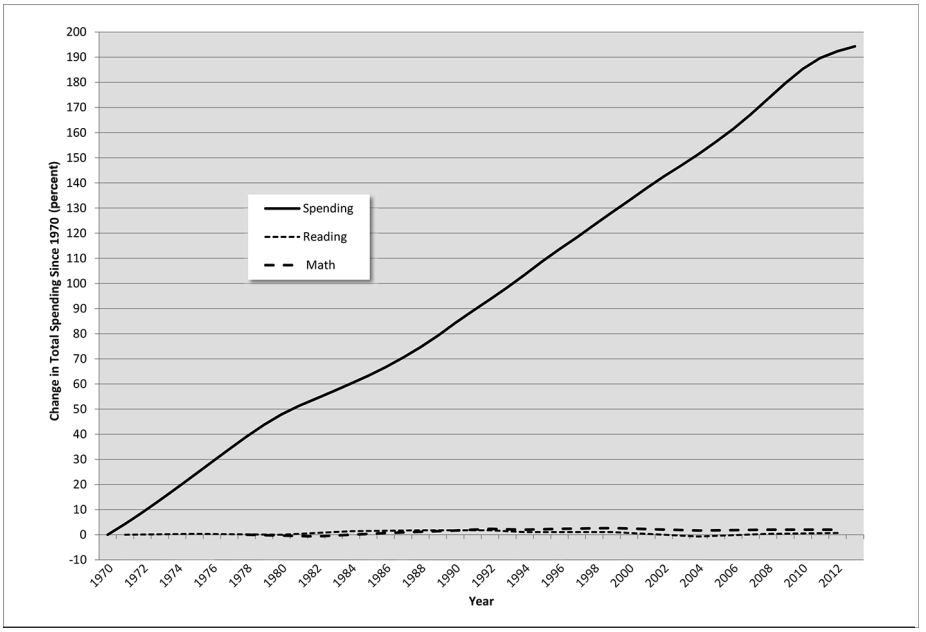
Outcomes

What have we gotten from ballooning federal spending and control? First of all, it is very difficult—perhaps impossible—to fully separate the effects of federal policy from numerous other variables that affect academic achievement. Those variables include state policies, local policies, students' family lives, and attitudes toward education. Thus, we cannot say definitively that federal policy caused something to happen or not happen. Nevertheless, the evidence strongly suggests that federal K–12 interventions have been largely ineffectual and almost certainly not worth the money expended on them. Note that "governance" does not include interventions by federal courts, most notably in *Brown v. Board of Education*, which have often been necessary to enforce the Fourteenth Amendment's equal protection requirements against state and district discrimination.

Historically, the evidence is powerful that neither government provision of schools nor compulsory attendance was needed for most people to educate their children. Numerous historians have noted that white Americans (blacks were often prohibited by law from receiving an education) had very high rates of literacy before there was significant provision of "common schools"; and very large percentages of Americans were sending their children to school before there were compulsory attendance laws. People valued education and did not appear to need government provision, which largely followed widespread education.

To assess learning in the modern era, the most consistent, national measure we have is the National Assessment of Educational Progress (NAEP) Long-Term Trend Assessment. The assessment is a federal test given to a nationally representative sample of students—but without stakes attached and, thus, insulated against "gaming"—which has remained largely consistent since the 1970s. What does it show? Looking at 17-year-olds over the decades, achievement is almost completely flat, even

Figure 47.1
Change in NAEP Long-Term Trend Results (17-Year-Olds) vs. Change in Total Spending for a Child's K–12 Education, in 2014 dollars, by Graduation Year, 1970–2012

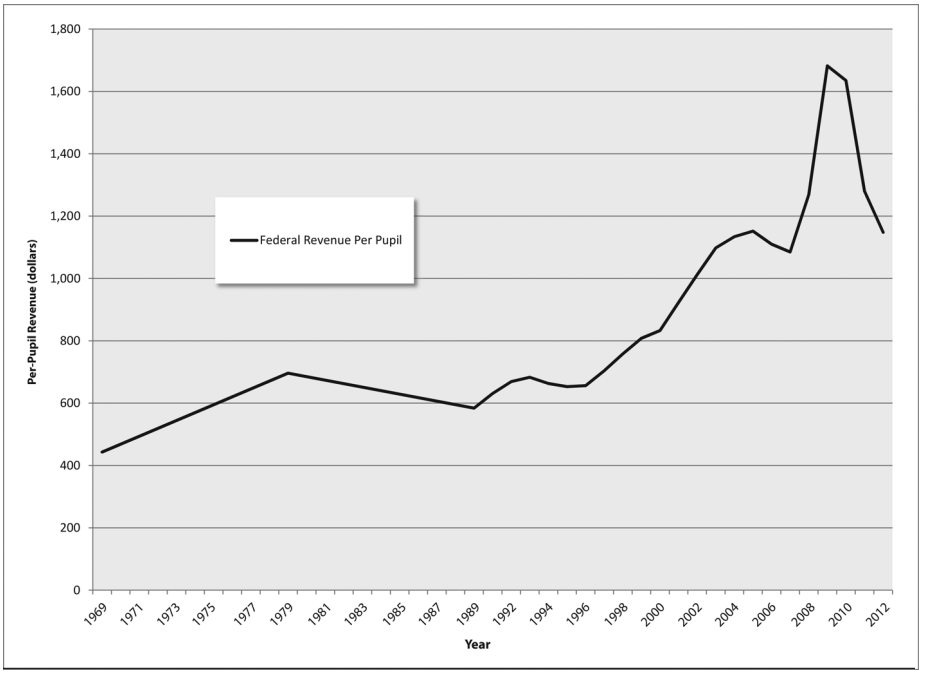


SOURCE: U.S. Department of Education, National Center for Education Statistics, *Digest of Education Statistics, 2015*, Table 236.55, https://nces.ed.gov/programs/digest/d15/tables/dt15_236.55.asp?current=yes (Missing data linearly interpolated); U.S. Department of Education, National Center for Educational Statistics, National Assessment of Educational Progress, http://nces.ed.gov/nationsreportcard/.

though—as Figure 47.1 shows—the inflation-adjusted expenditure on the average student's education has nearly *tripled*. That trend has been largely echoed by SAT scores; after controlling for numerous variables including self-selection of test takers, we see that those scores have also stagnated. We can also look at federal expenditures per pupil. As Figure 47.2 illustrates, inflation-adjusted federal spending per student rose from $443 in the 1969–1970 academic year to $1,148 in 2012–2013, again a near-tripling.

What do we see on NAEP during the No Child Left Behind period? It is difficult to pick a starting date for the NCLB period. The law was enacted in early 2002, but NAEP long-term trend exams were given in 1999 and 2004—neither very close to NCLB's first year. That said, both reading and math scores for 17-year-olds were slightly lower in 2012—the last time the exam was given—than in 1999 (the exam was also altered

Figure 47.2
Public School K–12 Revenue from the Federal Government, per Pupil, in 2014 Dollars, 1969–2012

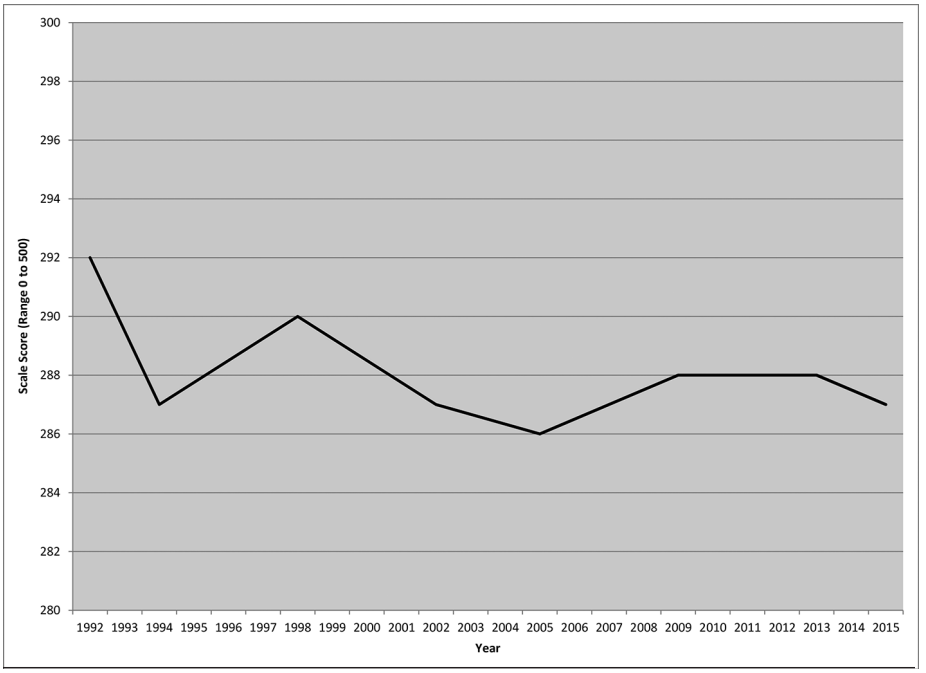


SOURCE: U.S. Department of Education, National Center for Education Statistics, *Digest of Education Statistics, 2015*, Table 235.10, https://nces.ed.gov/programs/digest/d15/tables/dt15_235.10.asp?current=yes.

in 2004, somewhat affecting comparability). We can also look at the "main" NAEP (more frequent exams given since the 1990s that are not necessarily meant to remain comparable over time) to get a sense of NCLB trends. Those are also disappointing, with average reading scores for 12th graders dropping slightly between 1998 and 2015 (Figure 47.3). Math scores are available only between 2005 and 2015, so they do not provide a pre-NCLB benchmark to try to discern the law's impact; scores increased slightly in that brief period (Figure 47.4).

National test scores for high school seniors have essentially not budged despite huge spending increases. That said, scores for younger students and some subgroups such as African Americans did improve over the NCLB period. The improvement occurred mainly at the beginning, which could reflect more a new emphasis on standardized testing—including testing strategies—than significantly improved learning. Meanwhile, some

Figure 47.3
Change in Main NAEP Reading Scores (17-Year-Olds), 1992–2015



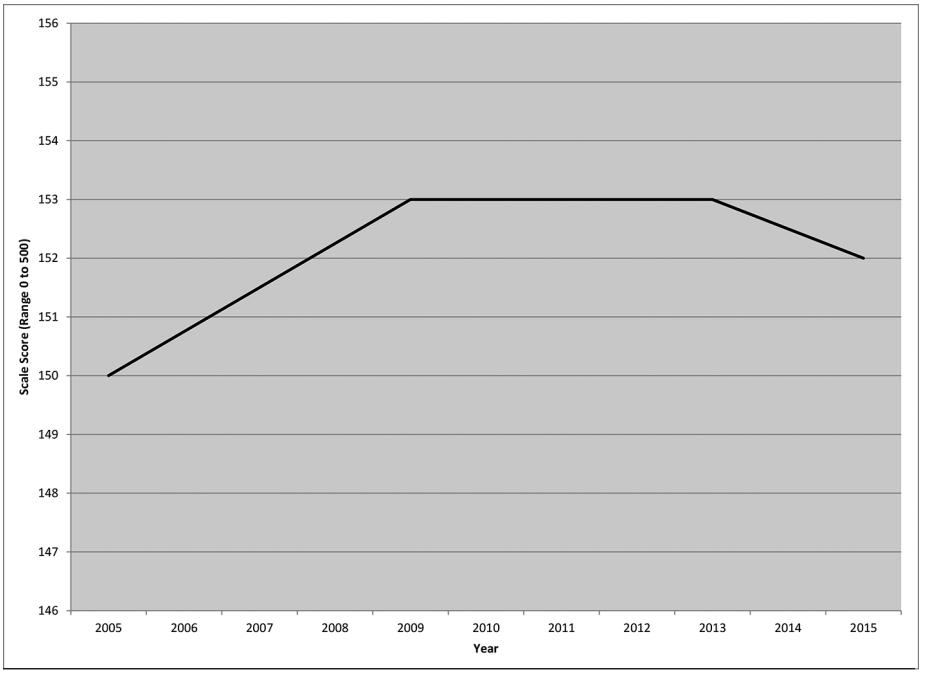
SOURCE: National Center for Education Statistics, *The Nation's Report Card: 2015 Mathematics and Reading at Grade 12*, http://www.nationsreportcard.gov/reading_math_g12_2015/#.

research that has tried to isolate the effects of NCLB has detected some possible benefit, but usually small and restricted to one subject. That is not bad news, but it hardly overrides the evidence that, in the final analysis, learning does not appear to have improved overall.

Recommendations

Perhaps as a result of the relatively poor outcomes indicated by standardized tests and, more likely, because of the public's broad rejection of education heavily focused on such tests, Congress determined that federal power in education should be reduced. The recently enacted ESSA is supposed to return much authority to the states. Senate education committee chair Lamar Alexander (R-TN) hailed it as "a dramatic change in direction for federal education policy," reversing "the trend toward what had become, in effect, a national school board." However, as the regulations are being drafted and debated, there is a very real danger that they will

Figure 47.4
Change in Main NAEP Math Scores (17-Year-Olds), 2005–2015



SOURCE: National Center for Education Statistics, *The Nation's Report Card: 2015 Mathematics and Reading at Grade 12*, http://www.nationsreportcard.gov/reading_math_g12_2015/#.

depart from the intent of the law and retain much federal control over standards, tests, and accountability systems. That must not be allowed to happen. Indeed, even if reforms based on "accountability" are effective, they originated in states such as Texas and North Carolina, and federal officials mainly observed those and decided they liked the idea. Then, instead of letting "laboratories of democracy" work, they imposed the model on all states, at the very least creating a national backlash against such policies, and perhaps dampening enthusiasm even in states that would have been inclined to adopt the approach on their own.

Ending the hyper-prescriptiveness of NCLB is only the start of what Congress should do. Ultimately, federal involvement in education should be eliminated, with the following exceptions: (1) enforcing the Fourteenth Amendment in states or districts that clearly discriminate against different groups in their provision of education; (2) exercising the federal government's fully constitutional authority over the District of Columbia and education on military bases; and (3) continuing "impact aid" for districts

with federal installations (that cannot be taxed) and the large concentrations of federally connected children those installations bring there. Even those three exceptions call for a light touch. The Department of Education's Office of Civil Rights has been too aggressive in declaring matters such as transgender bathroom access a federal concern when the nation has had little chance to contemplate and discuss the competing values—especially equality and privacy—at stake; it is generally best for the people of Washington, D.C., to exercise control over their own education system; and impact aid may well be too high and wasted.

One final concern is worth noting: empowering parents to choose educational options for their children is a powerful thing, enabling the people who know their children best to select their learning environments, and people with different norms and desires to avoid zero-sum battles. But that does not mean it is desirable for Washington to "voucherize" federal education spending. Doing so—except for the D.C. Opportunity Scholarship Program and for military dependents—would be unconstitutional. Just as important, it would create a very real danger of imposing national regulations over such things as standards and testing, ultimately rendering private schools nearly as homogenous as public. The motives behind such proposals as "Pell Grants for Kids" are good, but the dangers are too great.

Conclusion

The Constitution does not grant the federal government any authority to govern education, and for most of our history Washington stayed out. Over the past few decades, unfortunately, that changed—first with funding, then with control. Pinpointing the effect—or lack thereof—of federal intervention on education is difficult. But the evidence strongly suggests that, while Washington has driven no lasting improvements, it has marginalized and angered parents and other citizens. The federal government should drop the reins and let people at the state level decide where and how to exercise education authority.

Suggested Readings

Alger, Vicki E. *Failure: The Federal Misedukation of America's Children*. Oakland, CA: Independent Institute, 2016.

Arons, Stephen. *Short Route to Chaos: Conscience, Community, and the Re-Constitution of American Schooling*. Amherst, MA: University of Massachusetts Press, 1997.

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———. "State Education Trends: Academic Performance and Spending over the Past 40 Years." Cato Institute Policy Analysis no. 746, March 18, 2014.

Glenn, Charles L. *The Myth of the Common School*. Amherst, MA: University of Massachusetts Press, 1987.

McCluskey, Neal P. *Feds in the Classroom: How Big Government Corrupts, Cripples, and Compromises American Education*. Lanham, MD: Rowman & Littlefield, 2007.

Tooley, James. *The Beautiful Tree: A Personal Journey into How the World's Poorest People Are Educating Themselves*. Washington, DC: Cato Institute, 2009.

—Prepared by Neal McCluskey

48. Higher Education

Congress should

- phase out student aid programs, including grants, loans, and tax incentives;
- end the singular focus on for-profit colleges for censure; and
- reject proposals to incentivize more state spending on colleges.

In *Universities in the Marketplace*, former Harvard president Derek Bok observes, "Universities share one characteristic with compulsive gamblers and exiled royalty: there is never enough money to satisfy their desires." This chapter explores the harmful effects of federal involvement in higher education, especially distortions wrought by feeding colleges' insatiable financial cravings. When considered in conjunction with the Tenth Amendment dictum that "the powers not delegated to the United States by the Constitution . . . are reserved to the States respectively, or to the people," the message is clear: the federal government should withdraw from higher education.

Student Debt and Financial Aid: Where Are We Now?

The Great Recession brought with it a new focus on student debt and the price of college, issues made especially visible by three things: (1) in 2010, total student loan debt surpassed total credit card debt for the first time; (2) the 2011 Occupy Wall Street protests focused to a significant extent on college costs; and (3) in 2012, total student debt broke the psychologically huge $1 trillion mark. As a result, we have seen significant attention paid to the cost of college and to proposals by major presidential candidates that the federal government incentivize states to spend more

on their institutions of higher learning and make tuition either debt free or totally free.

This attention has come in the midst of significant expansions and reforms in federal student aid programs. For the past several decades, the federal government has been the primary provider of aid to students, through grants, loans, work study, and tax incentives for higher education expenditures. Since 2007, that role has grown significantly larger. The Bush and Obama administrations and Congress raised the maximum Pell Grant and expanded the percentage of students eligible for it, increased the maximum amounts available through loans, offered loan forgiveness for people who work for government or eligible nonprofit entities, introduced income-based repayment that caps payments at 10 or 15 percent of adjusted gross income and forgives remaining debt after 20 or 25 years, and cut interest rates on student loans.

Washington also changed how it finances loans, eliminating the "guaranteed" loan program in which borrowers obtained loans from ostensibly private lenders, but the federal government essentially guaranteed lenders a profit with the backing of federal dollars. That program was replaced with lending direct from the federal treasury. Finally, the Obama administration proposed creating a federal database on outcomes for every institution enrolling students with federal aid—almost every college—and eventually rating schools using measures such as graduation and loan-repayment rates. Facing major opposition from schools and policymakers over the rating idea, the administration eventually created the "College Scorecard," which enables users to find outcomes for first-time, full-time students 10 years after they enrolled at—but did not necessarily graduate from—a school.

Federal Aid: Seems Good, Is Probably Bad

A growing body of empirical literature strongly suggests that much federal financial aid does not translate into greater affordability for students. Instead, it has such unintended effects as these: institutions replacing their own aid dollars, state legislators decreasing direct subsidies, and just plain tuition inflation. In 1987, Secretary of Education William Bennett famously surmised that federal aid was encouraging tuition inflation. In a *New York Times* op-ed titled "Our Greedy Colleges," he wrote that "federal student aid policies do not cause college price inflation, but there is little doubt that they help make it possible." Essentially, when we give

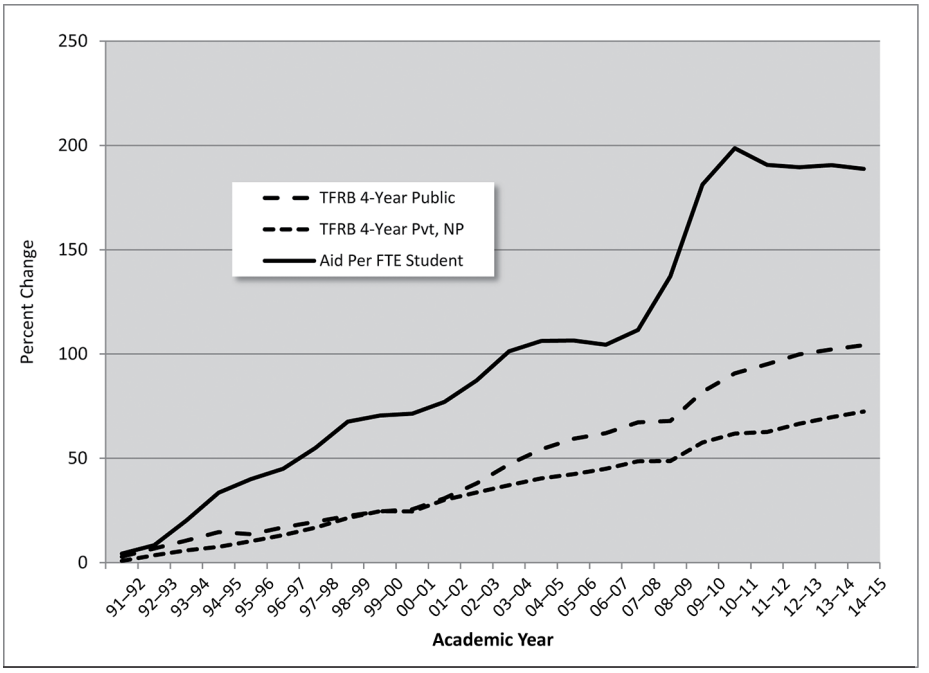
people money to pay for something, we give the providers the incentive to raise their prices.

Colleges are revenue maximizers. They can always think of something they could do with more money: start new programs, pay employees more, avoid cost-saving changes such as eliminating underutilized programs, build new fitness facilities or even a water park. Even economists Robert Archibald and David Feldman, who largely disagree with the "Bennett Hypothesis," tacitly concede this point in their book *Why Does College Cost So Much?* They argue that anything that might constrain colleges would at least appear to compromise "quality," which they seem to define as supplying everything someone might say is good, including not just

Top Five College Water Parks

1. University of Missouri "Tiger Grotto": According to the Mizzou website, "The Grotto will transform your dullest day into a vacation, with our resort quality facilities and atmosphere that will unwind you, even with the most stressful of schedules. The Grotto features a zero-depth pool entry with a high-powered vortex, lazy river and waterfall. Our hot tub, sauna and steam room will help you loosen up after a hard workout."
2. Texas Tech "Student Leisure Pool": According to Texas Tech's website, this is "the largest leisure pool on a college campus in the United States." It features, among other things, a 645-foot long, lazy river and a 25-person hot tub.
3. University of Alabama: According to the school's "University Recreation" webpage, the outdoor pool facility features, among other things, a "current channel," "spray features," a "tanning shelf," a "water slide," and a "bubble bench."
4. Missouri State: The school's pool features LED lights that change color at night, a 16-seat spa and sauna near the pool, and a 20-yard zip line.
5. Louisiana State University (under construction): The $84 million aquatics facility will feature a 536-foot lighted lazy river in the shape of "LSU," two "bubbler lounges," and a 21,000-square-foot sun deck made of "broom finished concrete with sand blasted etching of tiger stripes."

Figure 48.1
Percent Change in Aid per Full-Time-Equivalent Undergraduate Student and Published Tuition, Fees, and Room and Board Charges Since the 1990–91 Academic Year, Inflation Adjusted



SOURCE: College Board, *Trends in College Pricing 2015*, Table 2, http://trends.collegeboard.org/college-pricing/figures-tables/tuition-and-fees-and-room-and-board-over-time-1, and *Trends in Student Aid 2015*, Table 3, http://trends.collegeboard.org/student-aid/figures-tables/average-aid-student-over-time-postsecondary-undergraduate-graduate.
NOTE: TFRB = tuition, fees, and room and board; NP = nonprofit; FTE = full-time equivalent.

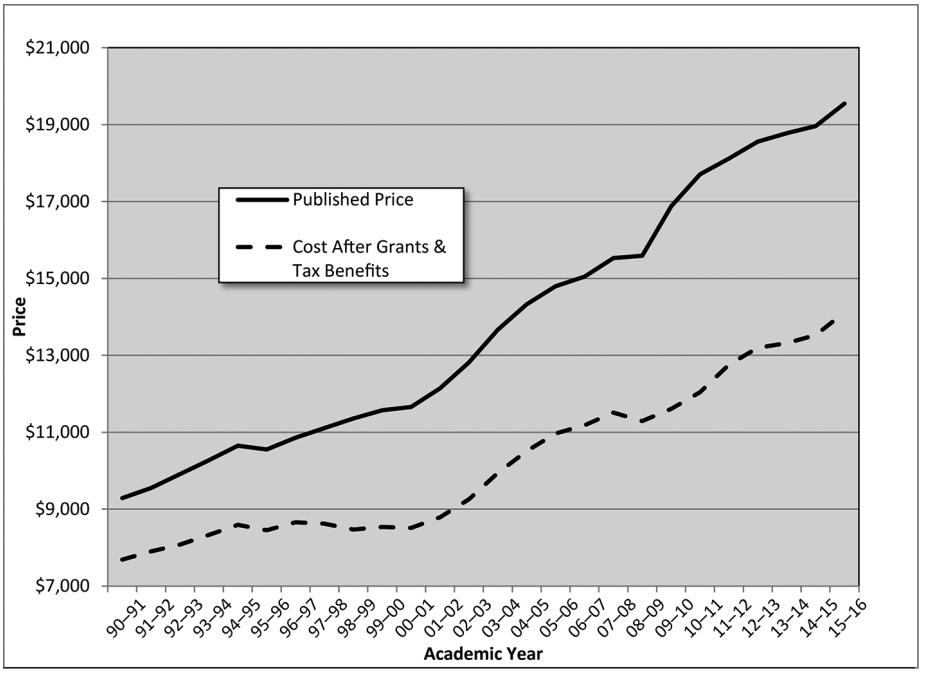
small classes, but also "research or public service" and limited adjunct professors.

Figure 48.1 illustrates that over roughly the last quarter century, inflation-adjusted aid per full-time-equivalent student has increased at a remarkable rate, nearly tripling. That increase has almost certainly abetted the doubling of inflation-adjusted tuition, fees, and room and board charges at public four-year institutions, as well as the roughly 75 percent increase in prices at four-year private schools. Of course, aid is not the only factor in college pricing. Skeptics of the Bennett Hypothesis often blame cuts in direct state and local subsidies to colleges as the primary culprit behind rising prices. But those cuts do not meaningfully affect private institutions, which receive very little in direct state and local subsidization. Plus, public

institutions have actually seen an increase in total state and local funding since 1990. Where there has been an appreciable funding reduction is on a per-pupil basis, but that is primarily a consequence not of tight-fisted states, but of enrollment increasing from 7.8 million to 11.1 million full-time-equivalent students between 1990 and 2015.

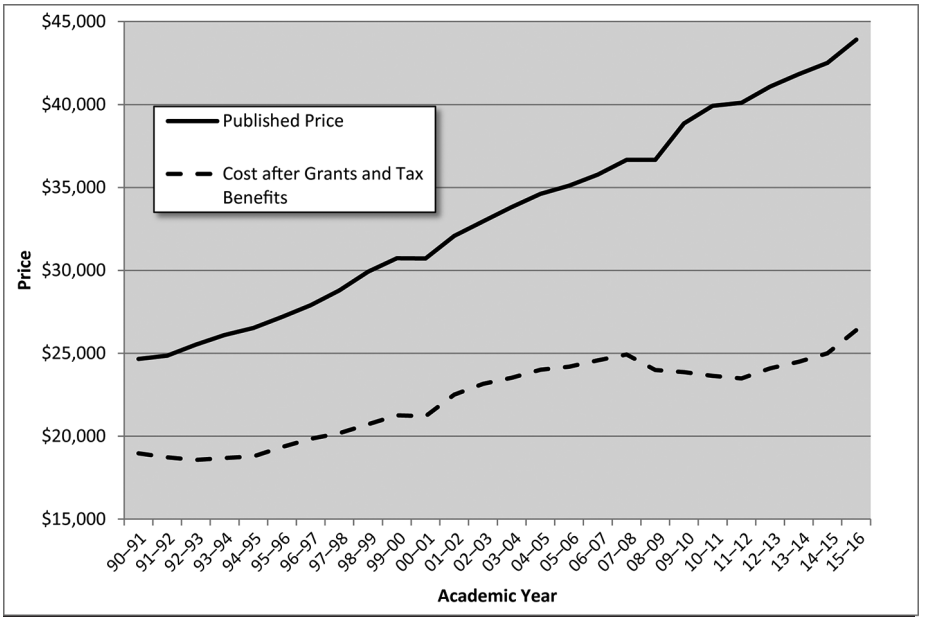
The effect of aid on what students actually pay, as opposed to the "sticker price" they are ostensibly charged, is partially illustrated in Figures 48.2 (public institutions) and 48.3 (private institutions). The illustration is only "partial" because the figures exclude student loans, which—at least in theory—must be paid back. In practice, student loans are cheap because of government subsidization, and they are often eligible for some level of forgiveness. They are also awarded to many people who almost certainly would be unable to get such loans on the private market, for both financial and academic reasons. They truly are *aid*. Of course, they also enable

Figure 48.2
Published Tuition, Fees, and Room and Board Charges (In-State) vs. Net Cost after Grants and Tax Benefits, Public Four-Year Institutions, in 2015 Dollars



SOURCE: College Board, *Trends in College Pricing 2015*, Table 7, https://trends.collegeboard.org/college-pricing/figures-tables/average-net-price-over-time-full-time-students-sector.

Figure 48.3
Published Tuition, Fees, and Room and Board Charges vs. Net Cost after Grants and Tax Benefits, Private Four-Year Institutions, in 2015 Dollars



SOURCE: Source: College Board, *Trends in College Pricing 2015*, Table 7, https://trends.collegeboard.org/college-pricing/figures-tables/average-net-price-over-time-full-time-students-sector.

students to pay what schools want to charge, the central point of the Bennett Hypothesis. That said, even looking only at prices—before tax benefits and grants (including institutional dollars)—we see the effect of aid. At public four-year institutions, while the inflation-adjusted sticker price of tuition, fees, and room and board rose 110 percent between 1990 and 2015, net prices rose only 84 percent. At private, four-year institutions, published prices grew 78 percent, but net prices rose only 39 percent. Loans helped cover the remaining difference.

Federal aid clearly enables colleges to ramp up their prices. It also likely gooses student demand for programs and amenities increasingly removed from academic necessity, including gourmet food, deluxe housing, lots of recreational and entertainment programming, and even on-campus water parks! Indeed, researchers Brian Jacob, Brian McCall, and Kevin Stange found that for all but the top academic performers, students put more

emphasis on schools' amenities than their academic offerings. That means many colleges may well be locked into an amenities "arms race" fueled, at least in part, by subsidies that incentivize students to demand lots of extras.

Perhaps this state of affairs would be tolerable if the higher education system performed magnificently, clearly imparting lots of new, crucial knowledge and skills. But much evidence suggests it does not.

First, roughly half of all students who enter college never finish. Many of those who do not finish have received aid despite being unprepared for college-level work. Thus, they often have debt but no degree with which to increase their earnings and repay what they owe. Indeed, small debtors comprise the biggest chunk of loan defaulters. The students with heftier debt levels have often gotten undergraduate degrees and gone on to graduate schools and usually earn enough to comfortably pay off their loans.

That said, even many who do finish college have difficulty finding work that requires their degree. According to a 2014 report from the Federal Reserve Bank of New York, approximately one out of every three bachelor's degree holders is in a job not requiring the credential. Meanwhile, the surfeit of degree holders is apparently leading to "credential inflation." According to research by the human resources firm Burning Glass Technologies, many job advertisements call for a degree even though the people currently occupying those positions typically do not have one, and the desired skills are not college level. Finally, while the wage premium for having a degree versus just completing high school is quite large—perhaps as much as $1 million over one's lifetime—earnings for people with at least an undergraduate degree have been essentially stagnant for roughly the last two decades.

At least people are learning a lot more, right? Perhaps not, at least according to the incomplete measures we have. Research by Richard Arum and Josipa Roksa indicates that college students reported spending 40 hours per week on academic pursuits in the early 1960s, but just 27 hours in 2011. Time spent studying declined from 25 hours per week in 1961 to 20 hours in 1980 and 13 hours in 2003. The National Assessment of Adult Literacy determined that, in 1992, about 40 percent of adults whose highest degree was a bachelor's were proficient in reading prose, but by 2003—the only other year the assessment was administered—only 31 percent were proficient. Among people with advanced degrees, prose proficiency dropped from 51 percent to 41 percent. To a large extent, a

degree seems to serve as a signal of someone's basic attributes—maybe general intelligence and ability to complete a long-term task—but does not necessarily indicate someone has obtained valuable skills. Still, employers can easily demand a degree because someone else is usually paying.

The U.S. System: Don't Make It Worse

As problematic as American higher education is, it works much better than either our elementary and secondary system, or most other countries' postsecondary systems. American universities dominate world rankings; the United States is the top destination for students pursuing studies outside of their home countries; and we have by far the greatest number of top scholars, including Nobel Prize winners. Why? Because as wasteful and distorting as aid to students is, it is far better to attach money to students and give institutions autonomy to govern and shape themselves than to have the government operate the schools and fund them directly. We want a system that can supply varied types of education and that allows students and schools to respond quickly to changing needs in the workforce. Freedom is much better suited to those goals than top-down control.

Of course, American higher education is far from perfect in that regard. Public colleges and universities receive heavy direct subsidies from state and local governments that render them significantly insulated from the pressures of student demands. And private, nonprofit schools often have big endowments or other sources of funds accumulated through tax-favored donations. For-profit colleges and, to a lesser extent, community colleges have often been the most responsive to changing workforce demands.

What that tells us is, first, Congress should not enact legislation that would offer federal funding to states in exchange for greatly increased subsidies to public colleges and lower or zero tuition. Although such legislation would reduce sticker prices and debt, it would render higher education even less efficient than the current system. And, of course, it would come with a hefty taxpayer price tag.

Second, Congress should cease the outsized assault we have seen on for-profit institutions over the last several years. Students who attend for-profit schools do tend to have relatively high loan default levels, and they do not earn as much as graduates of four-year public and private, non-profit schools. But for-profits work with the students with the greatest challenges—older, poorer, more likely to have families and full-time jobs—

even compared with community colleges. Moreover, for-profits tend to be relatively quick to expand or create new programs when demand arises and to scale down or end programs when demand subsides. In other words, they are best at responding to changing market demands. Nevertheless, like all sectors of higher education, they have inflated prices, big noncompletion problems, and too much debt default—due, in large part, to the artificial incentives created by student aid.

Removing the Federal Government from Higher Education

James Madison wrote in *Federalist* No. 45, "The powers delegated by the proposed Constitution to the federal government are few and defined. . . . [They] will be exercised principally on external objects, as war, peace, negotiation, and foreign commerce." Since the Constitution grants the federal government no role in higher education, Washington may only be involved in ways that support legitimate federal concerns. That essentially means maintaining the Senior Reserve Officers' Training Corps, service academies, and national defense–related research. Otherwise the federal government should withdraw from higher education.

Washington cannot, however, withdraw immediately. Abruptly ending federal student aid, especially, would leave millions of students scrambling for funds and would overwhelm private lenders, schools, and charitable organizations that have made plans based on expected levels of federal involvement. What follows is an overview of a six-year plan to withdraw the federal government from higher education:

- Two years: End direct federal aid to institutions. With the exceptions of Howard University and Gallaudet University, both of which are in the District of Columbia, colleges do not typically receive direct federal subsidies of major size. If schools are to be directly subsidized, state or local governments should do it. Also, federal tax incentives, which are heavily skewed to the well-to-do—such as 529 plans, Coverdell Education Savings Accounts, and Lifetime Learning Credits—should end, though existing savings should receive the tax treatment promised when the money was deposited.
- Four years: Phase out "unsubsidized" federal loans, which are loans available without regard to financial need. There is little justification for supplying loans to people who could otherwise afford to pay for college. The maximum available loan should be reduced in equal increments over four years, to a complete phaseout.

- Six years: Eliminate all federal student aid programs. Each year after the enactment of the federal phaseout, the maximum Pell Grant should be reduced in equal increments. Similarly, maximum "subsidized" loan sizes should be reduced in equal increments.

Conclusion

The federal presence in higher education is ultimately self-defeating, fueling artificially higher prices, incentivizing overconsumption, and making it harder and more expensive for people to access the education they need. The solution is not to incentivize greater direct subsidies for the ivory tower, but to eliminate the subsidies we already have. That will help transform the currently bloated, teetering ivory tower into manageably sized educational options accessible to everyone who needs them.

Suggested Readings

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Jacob, Brian, Brian McCall, and Kevin M. Stange. "College as Country Club: Do Colleges Cater to Students' Preferences for Consumption?" National Bureau of Economic Research Working Paper no. 18745, January 2013.

McCluskey, Neal P. "How Much Ivory Does This Tower Need? What We Spend on, and Get from, Higher Education." Cato Institute Policy Analysis no. 686, October 27, 2011.

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Vedder, Richard. *Going Broke by Degree: Why College Costs Too Much*. Washington: American Enterprise Institute, 2004.

—Prepared by Neal McCluskey

49. Pre-K Education

Congress should

- recognize that the promises of large returns on investment for universal preschool programs are grossly overstated;
- recognize that the high-quality research on large-scale preschool programs fails to find lasting positive effects on participating students;
- understand that a universal preschool program is likely to cost tens of billions of dollars without measurably improving student outcomes;
- end direct federal subsidies of preschool programs; and
- refrain from enacting a universal preschool program.

Perhaps the most popular new entitlement that politicians are proposing is universal preschool education. Because such a program would carry a hefty price tag—President Barack Obama called for spending $75 billion over 10 years—proponents often make grand claims about its return on investment. These claims are not supported by the research.

The studies on which proponents rely are of small-scale, high-intensity programs operational several decades ago that bear little resemblance to the large-scale, lower-intensity programs being proposed today. No high-quality research has found such big and lasting positive impacts from larger-scale programs. Indeed, the highest quality studies of the federal Head Start program and other larger-scale preschool efforts tend to find little to no lasting impact. In one example, by the time students reached second grade, Tennessee's preschool program had a *negative* impact on participating students.

The federal government has no constitutional authority to enact a universal preschool program. Even if it did, the research does not support

making such a huge financial investment in a program that is likely to produce little or no return. Moreover, because federal grants usually flow through state education agencies, they tend to fund programs that are housed in existing school facilities that are intended for older students and are unsuitable for three- and four-year-olds. By crowding out better-suited alternatives, government subsidies for preschool may actually make things worse.

Probing the Promises about Preschool Programs

Touting universal preschool is all the rage these days. In his 2013 State of the Union address, President Obama proposed "working with states to make high-quality preschool available to every single child in America" through a "Preschool for All" program that would cost $75 billion over 10 years. The president justified the price tag by pointing to research that supposedly indicates there would be a large return on the investment:

> Every dollar we invest in high-quality early childhood education can save more than seven dollars later on—by boosting graduation rates, reducing teen pregnancy, even reducing violent crime. In states that make it a priority to educate our youngest children, like Georgia or Oklahoma, studies show students grow up more likely to read and do math at grade level, graduate high school, hold a job, form more stable families of their own. We know this works.

Likewise, Hillary Clinton has claimed, "we already know that for every one dollar we spend on early childhood education, we reap seven dollars as a society in returns." In recent years, numerous gubernatorial candidates and state legislators have echoed calls for universal pre-K.

Those promises are not supported by the research. Universal preschool proponents generally rest their claims on research on the High/Scope Perry Preschool Project (the source of the "seven-to-one" rate of return claim) and the Carolina Abecedarian Project. Although research on both programs showed lasting results, both were very small, expensive, high-intensity programs in the 1960s and 1970s that differ significantly from the large-scale, low-intensity programs being proposed today. Moreover, as detailed below, high-quality research on comparable large-scale early education programs has failed to replicate the strong positive results from Perry and Abecedarian. As David Armor, a leading scholar on education policy and quantitative methods, explained in a 2014 Cato Institute report:

> There is a body of research that finds educational benefits from preschool programs, but these studies suffer from one of two problems: Either the preschool programs are not comparable with the programs being proposed today, or they use non-experimental designs that suffer from serious limitations, including an inability to track preschool effects into the early grades.

At present, there simply is insufficient evidence to conclude that large-scale preschool programs produce significantly positive results.

Examining the Evidence on Early Education

Georgia and Oklahoma

In his 2013 State of the Union, President Obama made specific reference to the state-funded preschool programs in Georgia and Oklahoma. Although research has suggested some benefits for disadvantaged students, there is little evidence that these programs have significantly improved educational outcomes for participating students overall. Moreover, the research used very limiting methods.

Georgia initially enacted a means-tested preschool program in 1992 and expanded it to include all children in 1995. Research finds some evidence that the program benefits some disadvantaged students, at least at first. A 2008 study by a researcher at Stanford University's Institute for Economic Policy Research found that "disadvantaged children residing in small towns and rural areas" who attended preschool in Georgia were more likely to have higher reading and math scores in fourth grade. However, the study found no consistent and statistically significant benefits to middle-income students. The researcher concluded that universal preschool failed a cost-benefit analysis:

> The costs of the program today ($302 million in 2007–2008) greatly outweigh the benefits in terms of potential increased taxable revenue. This is a very simple cost-benefit analysis and should therefore be interpreted with caution. However, it is at least suggestive that the government's scarce resources would be better spent on more targeted early childhood interventions that have been shown to be more cost efficient, particularly if the goal is to increase wages through test scores.

Oklahoma enacted a universal preschool program in 1998. A study of participating children in Tulsa found much larger positive impacts than in Georgia, the equivalent of about eight months of learning for verbal

skills. Although the results appear quite impressive, they may have been an artifact of the research design. A later study that examined preschool programs in five states, including Oklahoma, failed to detect similarly large results.

However, both the Georgia and Tulsa studies employed regression discontinuity design (RDD) instead of random assignment (the gold standard). In these studies, the test scores of children who just made the age cutoff for preschool are compared with those who just missed it. As Armor explained in 2014, there are several potential problems with this approach. First, attrition from the treatment group can bias results upward. This was a particular problem in the Tulsa study. Second, the variable used in RDD analyses to separate the treatment and control groups "must not be confounded with any other characteristic that might cause different behaviors in the treatment and control group." However, it is "likely that the age variable affects many other variables, such as the friends a child plays with, the amount of time spent in out-of-home care, and activities with parents," all of which can distort the findings. For example, parents of a child who is not going to attend preschool for another year are likely to treat her differently than if she were enrolled in preschool. Third, RDD analyses can only estimate the impact of a policy in a particular year. RDD cannot compare treatment and control groups over time because the control group enters preschool in the following year, and therefore RDD cannot tell whether any perceived effects are lasting or fade out. This is crucial because high-quality research on large-scale preschool programs has often found that positive effects fade out after just a few years.

To get a clearer picture of the effect of universal preschool programs, we should look to random-assignment studies of large-scale preschool programs that track students over time.

The High/Scope Perry Preschool and Carolina Abecedarian Projects

Proponents of universal preschool often point to two random-assignment studies that found positive outcomes for disadvantaged students. However, the programs that they studied differed significantly from the types of efforts under discussion today.

Beginning in 1962, the High/Scope Perry Preschool Project studied 123 children from low-income households in Ypsilanti, Michigan. The study randomly assigned 58 children to a "treatment group" and enrolled those students in the Perry Preschool; the remaining children formed a "control group" of students who were not enrolled. The study tracked

the outcomes of both groups through age 40, finding that participants in the treatment group were less likely to be arrested and more likely to graduate from high school, obtain employment, and earn higher incomes than the control group. Accordingly, the researchers estimated a societal return on investment of $7.16 for every $1.00 expended, factoring in increased tax revenues, decreased welfare payments, lower crime rates, and so on.

Like Perry, the Abecedarian Project studied a small-scale, high-intensity program for mostly black students from low-income households. The project studied 111 students beginning in 1972 in Chapel Hill, North Carolina, with a treatment group of 57 students. Decades later, researchers found that the program produced positive outcomes, including lower rates of teenage pregnancy and higher rates of college matriculation and employment in skilled jobs.

However, these findings should be interpreted with great caution. First, the sample sizes—fewer than 60 students in the treatment group in each study—are tiny. Second, both studies had flaws in their randomization process that may have biased the results. Moreover, even if there had been no methodological issues, it would be unwise to assume that large-scale programs would produce similar results because the two earlier programs differed significantly from the sorts of universal preschool programs proposed today.

Program management. Both programs were run by people who were trying to prove that their model worked, rather than by the types of people who would be staffing preschool centers in a large-scale program.

Services. Both Perry and Abecedarian were high intensity. Perry offered a student-to-teacher ratio of about five or six to one, held regular group meetings with parents and teachers, and even had weekly home visits. Abecedarian students received full-time, year-round care for five years beginning in their first year of life; individualized education activities that changed as the child grew; transportation; a three-to-one student-to-teacher ratio for younger students that grew to six-to-one for older students; nutritional supplements; social services; and more. Those services are not comparable to standard preschool programs, which have significantly more students per classroom and offer few of the above services.

Cost. In 2016 dollars, Perry cost more than $21,000 per student and Abecedarian cost more than $22,000, compared with less than $7,000 per student on average in most state programs. No one is proposing spending anything remotely close to that amount per student today.

Students. Whereas the Perry Preschool and Abecedarian projects were targeted to at-risk students from low-income households, universal preschool programs would also include students from middle- and upper-income families who are not nearly as likely to reap such large benefits.

The Perry Preschool and Abecedarian projects simply bear no resemblance to the sorts of programs being proposed today. Grover J. "Russ" Whitehurst of the Brookings Institution colorfully cautioned against extrapolating from Perry and Abecedarian, which he said "demonstrate the likely return on investment of widely deployed state pre-K programs . . . to about the same degree that the svelte TV spokesperson providing a testimonial for Weight Watchers demonstrates the expected impact of joining a diet plan."

Proponents of universal preschool also point to a few others studies, including those on the Abbott program in New Jersey, the Boston Preschool Program, and Chicago Child-Parent Centers. But none of those studies were gold-standard studies of large-scale programs that tracked students over time.

Results from Rigorous Research on Large-Scale Programs

As noted above, the best test of universal preschool is research that employs the most rigorous method—random assignment—and studies the impact of large-scale programs over time. Although studies meeting those criteria have found some short-term gains, the gains fade after just a few years. No rigorous research has found lasting gains from large-scale programs.

Head Start

Perhaps the most relevant research pertains to the federal Head Start program: that research is national in scope and tracked students through third grade. Enacted in 1965, Head Start provides educational and social services to low-income families nationwide. In 2015, it served nearly 1 million students (approximately 10 percent of the nation's 3- and 4-year-olds) at an annual cost of about $8.5 billion.

According to Brookings' Whitehurst, the federal government's Head Start Impact Study (HSIS) was "one of the most ambitious, methodologically rigorous, and expensive federal program evaluations carried out in the last quarter century." The HSIS followed a cohort of over 4,500 students who were 3 or 4 years old in the fall of 2002. It employed

random assignment, drawing a sample of about 2,600 students who had applied to more than 300 Head Start centers in 23 states. That sample was contrasted with a control group of about 1,800 children. The study employed statistical techniques to account for some treatment group students who got into but did not attend Head Start, as well as some control group students who found other preschools. The HSIS found modest gains for participating students on both reading and math scores during their preschool years and some positive effects for social behaviors. However, those effects did not last beyond kindergarten. On tests at the end of first and third grade, the treatment and control groups were statistically indistinguishable.

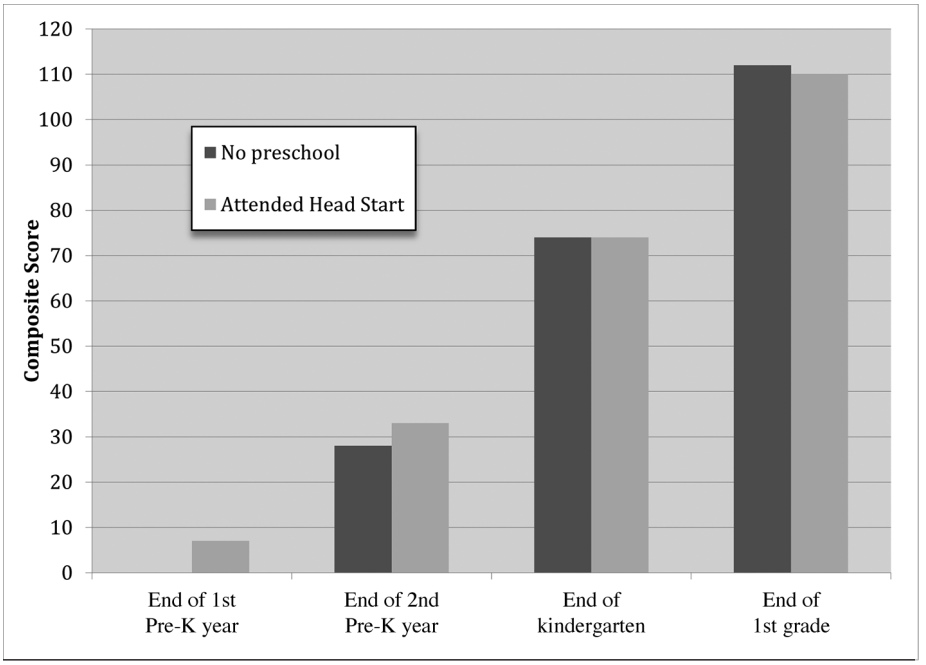
The results of the study were so disappointing for Head Start boosters that the Obama administration released the results in 2012 on the Friday before Christmas—a day on which they were least likely to get any attention.

In a reanalysis of the data, Dr. Peter Bernardy compared only treatment group students who remained in Head Start for at least two years against control group students who did not attend another preschool. Bernardy's reanalysis likewise found that any early gains faded by the end of kindergarten. Moreover, as shown in Figure 49.1, the control group students scored two points higher than the Head Start students by the end of first grade, although this difference was not statistically significant.

Some Head Start proponents have theorized that perhaps there are "sleeper effects" from the program that only turn up much later. Whitehurst has criticized that theory, noting that "research on the impacts of early intervention consistently shows that programs with longer-term impacts also evidence shorter-term impacts in elementary school." It is highly unlikely that Head Start is producing significant and lasting positive effects that are undetectable in the interim.

Nevertheless, one 2016 study by the Hamilton Project at the Brookings Institution purports to find such "sleeper effects," including increased rates of high school graduation and post-secondary attainment. However, unlike the Impact Study, the Hamilton study did not employ random assignment. Instead, using data from the National Longitudinal Survey of Youth, the Hamilton study attempts to generate treatment and control groups by comparing the outcomes of people who had attended Head Start against the outcomes of siblings who did not. In order for this method to truly isolate the impact of Head Start, the sibling pairs must have the same average characteristics, except for Head Start attendance. The authors

Figure 49.1
Academic Skill Gains for Head Start vs. Control



SOURCE: Peter M. Bernardy, "Head Start: Assessing Common Explanations for the Apparent Disappearance of Initial Positive Effects." PhD diss. (Fairfax, VA: George Mason University, 2012).

concede that this assumption does not necessarily hold. Parents' decisions to enroll one child in Head Start and not another may suggest significant yet unobserved differences.

In another 2016 study, researchers from Georgetown University found lasting gains for students who had participated in Tulsa's Community Action Project Head Start, including positive effects on middle-school students' math test scores (but not reading scores), grade retention, and chronic absenteeism overall, and for some subgroups, such as girls (but not boys) and white and Hispanic students (but not black students). Yet again, the study did not employ random assignment. Instead, the researchers matched students for comparison based on several demographic variables, meaning that the study may suffer from selection bias. Unlike the random-assignment Impact Study, the parents of the treatment group students in the Georgetown study actively chose to enroll their children in Head Start, whereas the parents of the matched comparison group

did not, meaning that there could be significant, unobserved differences between these two populations that cannot be eliminated merely by controlling for demographic characteristics. Moreover, as the authors concede, Tulsa's CAP Head Start program "is not representative of Head Start programs across the country." Tulsa's program has had "higher scores on observational assessments of instructional quality and on time spent on academic instruction than was true of an 11-state sample of Head Start programs assessed at the same time."

Although the Georgetown study provides some suggestive evidence that certain types of early education programs may have some lasting positive impacts for some types of students, the highest quality research on Head Start programs nationwide shows that any initial gains are, on average, short lived.

Tennessee Voluntary Pre-K Initiative

In 2005, Tennessee enacted the Voluntary Pre-K Initiative, which gave priority to high-risk students (e.g., those in poverty, children with disabilities, and students with limited English proficiency). By 2007, more than 18,000 students were participating. The program was deemed "high quality" because, like similar programs in Tulsa and Boston, teachers had to be licensed and instruction was offered for a minimum of 5.5 hours for five days a week (usually 6 to 8 hours). Tennessee was also one of the 18 states to receive some of the $226 million in federal Preschool Development Grants in 2015.

Researchers at Vanderbilt University conducted a random-assignment study with a sample size of 3,000 students. Because of a problem with the randomization—parental permission to collect data was obtained only after the students had been randomly assigned to control and treatment groups—the researchers had to rely on a statistical technique known as propensity analysis to compensate. As with Head Start, the study initially found significant positive effects on academic performance during preschool, but those effects faded. By second and third grade, the participating students actually scored worse than the control group.

The Tennessee example also demonstrates how federal subsidies can distort the market. Because the grants flow primarily through state education agencies, the funds generally support programs operated in existing district schools. When preschool programs are housed in facilities built for older students, bathrooms and cafeterias are often relatively far from their classrooms. Vanderbilt's observational research found that transition

time between activities consumed the largest chunk of time during the day (about 25 percent). By contrast, only about 3 to 4 percent of the time was spent on outdoor play or gym time, and many students had no opportunity to run or play. Once again, housing a preschool in a district school was a contributing factor because their playgrounds are generally designed for older students.

Conclusion and Recommendations

Proponents of universal preschool rest their case on a thin empirical reed. The programs that produced large and lasting positive effects were small, high-intensity, prohibitively expensive, and not comparable to the sorts of programs being proposed today. In contrast, the most rigorous research on large-scale programs has consistently found that positive effects tend to fade within a few years. Even if the Constitution granted the federal government the authority to do so, the research literature does not support enactment of a universal preschool program. Instead, Congress should end subsidies for preschool programs, such as Head Start and the Preschool Development Grants.

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—Prepared by Jason Bedrick

50. Housing and Urban Development

Congress should

- fully privatize Fannie Mae and Freddie Mac as it did for Sallie Mae in 1995;
- phase out the mortgage interest deduction;
- eliminate Federal Housing Administration guaranteed loans;
- eliminate urban renewal funds to states and municipalities; and
- abolish the Department of Housing and Urban Development and fold remaining HUD programs into the Department of the Interior (Indian housing), Department of Commerce (disaster relief), Department of Justice (Fair Housing Act), or other appropriate departments.

State legislatures should

- repeal any growth-management laws or similar legislation and restrict the ability of counties to control land uses; and
- repeal laws permitting municipalities to use tax-increment financing to fund urban redevelopment.

The Federal Government's Four Housing Programs

The Department of Housing and Urban Development (HUD) oversees or monitors four major programs: housing subsidies to the wealthy; housing subsidies to the poor; fair housing; and urban renewal (which usually involves construction of new housing). As administered by HUD, all of these programs suffer from such serious flaws that the nation is better off without them.

Housing subsidies to the wealthy—including Federal Housing Administration loan guarantees, Fannie Mae and Freddie Mac (which are moni-

tored by HUD), and mortgage interest deductions—are supposed to increase homeownership rates. But these programs actually have only minor effects on homeownership. Economists Edward Glaeser and Jesse Shapiro have shown that the mortgage interest deduction is "irrelevant" to homeownership rates in the United States.

Few other nations offer any of these subsidies and none have all three. Yet compared with other nations, American homeownership rates are average at best. Australia, for example, offers none of these subsidies to housing but has a higher homeownership rate and builds new homes that are larger, on average, than new American homes. Brazil and Mexico have significantly higher homeownership rates than the United States without any of these programs.

The mortgage interest deduction alone represents a benefit of at least $70 billion per year, three-fourths of which goes to homeowners with incomes above $100,000 per year. The other two programs are also unduly biased toward the relatively wealthy.

Congress should phase out the mortgage interest deduction over 10 years and replace it with a revenue-neutral, across-the-board tax reduction. Federal Housing Administration loan guarantees should be eliminated. Further, Fannie Mae and Freddie Mac should be fully privatized and subject to scrutiny by the Securities and Exchange Commission. If they fail, they should be allowed to go bankrupt like any other private business.

Federal housing subsidies to the poor are no more than a third of the size of those to the wealthy, totaling around $26 billion in 2015. Even so, these programs can be just as misdirected and useless as the subsidies to the wealthy. Federal low-income housing programs—including public housing, Section 8 vouchers, and Section 8 project-based assistance—reach only about 20 percent of the people who are eligible, and many of the remainder are on long waiting lists. Of the three programs, vouchers reach the most people (more than 5 million vs. 4.2 million for the other two programs combined), cost taxpayers the least, are least susceptible to corruption, and probably work the best in giving low-income families economic opportunities without trapping them in the welfare system.

One problem with many public housing programs is that they have been hijacked by supposedly nonprofit organizations that lobby heavily to maintain their subsidies even as they do little to correct real housing affordability problems. For example, an organization called Enterprise Community Partners gets most of its funds from federal grants and spent only 21 percent of its 2014 revenues on grants aimed at providing

affordable housing. Well over 60 percent of its revenues went to salaries, pensions, or professional service contracts. In 2014, it paid its chief executive nearly $900,000 and paid at least 16 other people more than $200,000. The U.S. government gets along with one vice president; Enterprise Community Partners has at least 23, many of whom were paid more than taxpayers paid Joe Biden in 2014, and all of whom were paid more than $160,000.

Affordable Housing Versus Housing Affordability

Whether at the federal, state, or local level, the job of providing affordable housing to the poor has become much more expensive thanks to the growing housing affordability crises in many urban areas and states. While "affordable housing" refers to subsidized housing for low-income people, "housing affordability" refers to the general level of housing prices relative to incomes. One standard measure of housing affordability is median home prices divided by median family incomes, or the value-to-income ratio.

A family buying a home that costs less than three times their income can devote 25 percent of their income to pay off the mortgage in less than 30 years. Since banks typically require that homebuyers spend no more than a quarter of their incomes on their mortgage, value-to-income ratios less than 3 are affordable, ratios greater than 3 are marginally unaffordable, and ratios greater than 4 are unaffordable.

By that measure, housing throughout America, except Hawaii, was all affordable in 1969. At the time, value-to-income ratios in major urban areas ranged from 1.5 in San Antonio to 2.6 in New York (and 3.2 in Honolulu). Today, most urban areas remain affordable, but median home prices in some major urban areas have climbed to more than five times median family incomes. As of 2014, the ratio in Santa Barbara, California, was a staggering 9.3. Ratios are particularly high in California, Hawaii, Massachusetts, New Jersey, New York, Oregon, and Washington state.

With the exception of New York, what these states have in common is growth-management laws that attempt to confine urban growth to certain areas using urban-growth boundaries, urban-service boundaries, greenbelts, or other restrictions. New York City housing is unaffordable partly because it is surrounded by New Jersey and Connecticut, both of which have growth-management laws, and because of rent control and other regulations that discourage the construction of new housing. Other urban areas in New York state are affordable. Hawaii was the first state to

pass a growth-management law—in 1961—which is why it was marginally unaffordable even in 1969.

In addition to these states, many urban areas have adopted growth-management plans that have made housing unaffordable. Boulder, Colorado, has purchased a large greenbelt around itself that has made it the least affordable urban area in the United States outside of California, Hawaii, and New York. Nearby Denver also has an urban-growth boundary. In all, about 40 to 45 percent of American housing is unnecessarily expensive due to state or local growth-management laws.

Advocates of growth management say it protects farms and open spaces, saves energy, and reduces pollution and greenhouse gas emissions. But the United States has a relative surplus of farms and open spaces: the Department of Agriculture says the nation has nearly 1.1 billion acres of agricultural land but grows crops on only a third of those acres. Moreover, the number of acres needed for croplands is declining because per-acre productivity of major crops, including wheat, corn, soybeans, and many others, is growing faster than the nation's population. As for open space, all of the nation's urban areas with populations greater than 2,500 cover just 3 percent of the nation's land. Even the most urbanized state, New Jersey, is more than 60 percent rural open space.

Saving energy and reducing greenhouse gas emissions might be more important, but growth management is not the way to achieve those goals. Based on an extensive literature review of the relationship between urban form and energy/emissions, University of California, Irvine, economist David Brownstone concluded that the connection between the two was "too small to be useful." There are far better ways of saving energy and reducing emissions that cost less and don't make housing expensive—for example, encouraging people to buy more fuel-efficient cars and homes.

Rather than fixing housing affordability problems by repealing growth-management laws and plans, local officials have elected to address the issue using affordable housing funds, thus putting pressure on the federal government to spend more money to make up for local economic mismanagement. Of course, affordable housing programs help only a small number of people, while the housing affordability issues created by growth-management programs make housing less affordable for all renters and

homebuyers and significantly increase the share of families suffering from housing distress.

In addition to leaning heavily on federal housing funds, many cities have adopted affordable housing policies that actually make the overall housing market less affordable. For example, some cities tax new homes to fund the construction of affordable homes while others require homebuilders to sell or rent 15 to 25 percent of their homes to low-income families at below-market prices. Both of those policies make housing less affordable by discouraging new construction and increasing the cost of new market-rate homes (which, in turn, increases the price of existing homes for sale).

Growth-management policies hit low-income families the hardest. In particular, blacks—whose per capita incomes remain at about 60 percent of white per capita incomes—have been forced to move to lower-quality housing or even out of urban areas that practice growth management. Between 2000 and 2010, the population of the San Francisco–Oakland urban area grew by more than 285,000 people, but the black population declined by nearly 49,000. Boulder, Honolulu, Los Angeles, and San Diego also saw their black populations shrink; in Denver and Portland, Oregon, black homeownership rates declined as increasing numbers of blacks were forced to move from single-family to multifamily housing.

HUD is supposed to monitor fair housing practices and has issued regulations against land-use policies that effectively discriminate against low-income minorities by making housing less affordable. But instead of challenging growth-management practices, the Obama administration has focused on reducing segregation through a program known as "affirmatively furthering fair housing." Under this program, any municipality that receives federal low-income housing funds must compare its mix of races and ethnicities with that of the region in which it is located and take steps to reduce segregation if it doesn't have enough minorities.

Unfortunately, affirmatively furthering fair housing attacks the wrong problem. Census data reveal that segregation is declining everywhere. But in affordable regions, it is declining because more minorities are moving into historically white neighborhoods and new neighborhoods are fairly well integrated; in *un*affordable regions it is declining because whites are moving into more affordable housing in historically minority neighborhoods, pushing the minorities into inferior housing and sometimes completely out of the region. Affirmatively furthering fair housing threatens to penalize the former while rewarding the latter.

Urban Renewal

HUD's fourth major program, community redevelopment, was originally created to help restore slums and other "blighted" neighborhoods, meaning neighborhoods whose condition was so bad that private investors would not spend any money to improve them. While some question whether such neighborhoods ever truly existed, it is clear today that so few true slums exist that many cities are declaring thriving neighborhoods and even greenfields to be blighted so they can use federal, state, and local funds to redevelop those neighborhoods. Such redevelopments are driven more by crony capitalism and social engineering programs than by the need or desire to remove blight.

For example, many cities use urban redevelopment funds to subsidize the construction of high-density housing. Supposedly, millennials prefer high-density housing over single-family homes. If so, there would be no need for subsidies. In fact, high-density housing is a part of the same growth-management programs that restrict the amount of land available for urban growth. The mantra of growth-management supporters is "grow up, not out," and they believe higher densities will reduce driving, saving energy and cutting greenhouse gas emissions.

Thus, the push for high-density housing overrides the desires of Americans, the vast majority of whom would prefer to live in single-family homes if they could afford them. Moreover, the environmental benefits of high-density housing are negligible if they exist at all; there are far better ways to save energy and reduce emissions that don't make housing unaffordable or require Americans to change their lifestyles. While there is nothing wrong with developers building high-density housing if a market for such housing truly exists, there is no need for the federal government to use taxpayer dollars to support such social engineering.

In addition to federal funds, most urban redevelopment is funded using tax-increment financing, which uses property (and sometimes sales) taxes that would otherwise go to schools, fire departments, and other agencies to subsidize developers. City officials often claim this is "free money" because the taxed developments would not have taken place without the subsidies; but studies show that cities that use tax-increment financing grow no faster and may even grow slower than cities that don't. That means urban redevelopment through tax-increment financing is a zero-sum and possibly a negative-sum game, as the developments would have taken place without the financing, though possibly in a different form

and location. Tax-increment financing was first used in California, but that state abolished such programs in 2011; other states should do the same.

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—Prepared by Randal O'Toole

51. Interior Department and Public Lands

Congress should

- privatize the lands held by the Forest Service and the U.S. Department of the Interior, or, failing that;
- reform the public land agencies by turning individual forests, parks, refuges, and Bureau of Land Management districts, or combinations of those units, into fiduciary trusts;
- allow those trusts to charge a broad range of user fees at market rates;
- fund the trusts exclusively out of a share of those user fees;
- dedicate some or all of the remaining user fees to special stewardship trusts whose goal is to maximize the nonmarket, stewardship values of the land;
- transfer fire suppression programs to the states by having public land agencies join state fire protection districts; and
- reform the Endangered Species Act to compensate private landowners for protecting wildlife habitat and to allow privatization of some wildlife to promote recovery efforts.

The occupation of the Malheur National Wildlife Refuge in Oregon in early 2016 focused attention on federal lands and prompted proposals to turn some or all of those lands over to the states. The ranchers who engaged in the Malheur protest were almost certainly wrong in their belief that public lands should belong to them, but environmentalists and other user groups can be just as dogmatic about their views of public lands. Such conflicts are an inevitable result of political management of resources: the various parties take extreme positions so that whatever compromises are made will end up closer to their preferred outcome.

For most of U.S. history, private landownership has been a driving force of the American economy. Yet more than a quarter of the United States remains in federal ownership. Most of that land is managed by the Department of Agriculture's Forest Service and the Department of the Interior's Bureau of Land Management (BLM), National Park Service, and Fish and Wildlife Service. The 618 million acres of land managed by these four agencies is slightly less than the combined land areas of Arizona, California, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, and Washington.

Many Americans are proud of the legacy offered by federal lands for present and future generations, especially the national parks, forests, and other lands that provide significant amounts of recreation. Yet that pride overlooks several problems with public land management:

- Federal land management currently costs taxpayers more than $8 billion a year.
- Much of that money is spent on things that are not necessarily good for the environment.
- A relatively small number of people get most of the benefits, while everyone pays the costs.
- Among the biggest beneficiaries are the bureaucracies themselves, which skillfully manipulate public opinion and members of Congress to increase their budgets.

Several Cato Institute studies have endorsed privatization of the public lands, a solution that is strongly resisted by environmentalists, recreationists, and many other public land users. A second-best solution that will both enhance the values sought by environmentalists and public land users and correct the fiscal problems of the current system is to turn the public lands into "fiduciary trusts." In this proposal, the United States would retain title to the lands, but the rules under which they are managed would be very different.

Fiduciary trusts funded out of their own revenues would make federal land managers more responsive to public land users, especially recreationists who would probably be the source of the vast majority of revenues. Besides saving taxpayers billions of dollars per year, trust management would be sustainable and sensitive to a wide range of environmental concerns.

Public Lands Cost Taxpayers $8 Billion a Year

In 2015, taxpayers spent $8.85 billion managing national forests, parks, wildlife refuges, and BLM lands. In return, not counting energy and

mineral revenues, those four agencies collected less than $2 billion in revenues. Worse, Congress allowed the agencies to keep, or directed them to turn over to states and counties, virtually all of that $2 billion, leaving none for the U.S. Treasury. In fact, national forest payments to counties were $21 million more than the revenues, meaning the lands lost money for American taxpayers even without counting the costs of management.

The only real revenues earned by public lands were on-shore oil, gas, coal, and other mineral revenues collected by the Interior Department's Office of Natural Resources Revenue. These revenues totaled about $3.8 billion in 2014, nearly half of which was shared with the states and more than a third of which went into a reclamation fund. That left just $584 million going to the U.S. Treasury—less than 7 percent of the cost of managing the lands. Almost all of this revenue came from coal, oil, and gas extracted from less than 1 percent of the federal lands, which means the other 99 percent cost taxpayers more than $8 billion and returned virtually nothing.

Most government agencies lose money. Yet the lands and resources managed by these agencies are so valuable, it seems incredible they could lose so much. The basic problem is that Congress has blocked the agencies' ability to make money and, in some cases, has actually given the agencies an incentive to lose money. Those directives, in turn, lead to other problems, including environmental damage due to misallocations of resources, over-production of subsidized resources, inequitable distribution of benefits, and unfair competition with private landowners who market many of the same resources.

Forest Service studies show that, if the agency was allowed to charge market rates for all resources, it could collect more than $10 billion per year. Similar fees could no doubt be collected on other federal lands.

In other words, federal land user fees would be more than sufficient to pay the costs of managing the public lands if only Congress would allow managers to charge market rates for all forest uses. In addition to saving money, funding public lands out of user fees would give managers incentives to protect and produce the resources that users value the most. Moreover, freed from unfair competition from public lands, owners of private land would have an incentive to charge fees for recreation and to alter their management to favor the scenery, wildlife habitat, and other features that people value for recreation.

If public lands are as valuable as people say, they should pay their own way. This means Congress should

- allow public land managers to charge fair market value for all resources;

- allow managers to keep a fixed share of the receipts for all resources; and
- reduce appropriations to zero and fund the lands exclusively out of their own receipts.

Wildland Fire

Wildfire is probably the biggest federal land issue today. Paradoxically, though Congress has significantly increased wildfire budgets, more acres are burning than ever before, and wildland fires destroy hundreds of homes and other structures each year.

After the Cerro Grande fire destroyed hundreds of Los Alamos, New Mexico, homes in 2000, Congress asked the Forest Service and the Interior Department to prepare a National Fire Plan. Under this plan, wildfire budgets have more than quadrupled from levels of the early 1990s. Yet the number of acres burned has grown, more homes are burned, and Forest Service research has shown that thinning and prescribed burns do little to protect structures on adjacent lands. "Wildland fuel reduction for reducing home losses may be inefficient and ineffective," says Forest Service fire scientist Jack Cohen.

Historically, Congress has given the Forest Service a blank check to suppress wildfires. As a result, the agency spends wildly compared with Department of the Interior agencies and state fire protection districts. The Forest Service routinely spends more than five times as much money on suppression per national forest acre burned as the Interior Department spends on its lands. In 2015, the Forest Service spent a record amount of money on fire suppression even though the number of national forest acres burned was less than two-thirds of the record number.

Thanks to the Forest Service's skillful manipulation of the fire story, most proposals from Congress call for giving the agency even more money, which is like trying to put out a fire by throwing gasoline on it. Short of complete reform of the agencies as described below, a better response would be for the Forest Service and other agencies to contract out fire protection to the states, which the Bureau of Land Management already does on some of its lands. This would involve paying the states a fixed amount per acre per year, similar to what private landowners pay, and then letting the states handle the fire suppression.

Endangered Species

The Fish and Wildlife Service manages national wildlife refuges and, in addition, is responsible for endangered plants, wildlife, and freshwater

fish. Congress passed the Endangered Species Act with the noblest of intentions. But the law's methods of carrying out those intentions unfairly places the burden of recovering endangered species populations on any landowner whose land happens to be home to an endangered species.

Landowners naturally resist this burden, so it is no surprise that few species have actually been recovered by the Endangered Species Act. Even public land managers have been known to resist recovery efforts when those efforts interfere with what the managers perceive to be their primary missions. Efforts to streamline the Endangered Species Act have focused on reducing costs to private landowners, but they have failed to create incentives that would motivate landowners to actually protect species.

To truly reform the act, Congress needs to create a trust fund or funds that can be used to pay landowners to protect wildlife habitat. Congress should also give the Fish and Wildlife Service the option to privatize some species of wildlife. Private owners are likely to develop innovative ways of protecting and restoring depleted wildlife populations. Such private ownership is common in Britain, but the closest we have come has been the successful efforts by private bird lovers to recover the peregrine falcon. Private ownership of selected species of wildlife could harness entrepreneurial energy on behalf of entire species.

A private owner of, say, black-footed ferrets, Columbian white-tailed deer, or northern sea otters would have the right to own individual members of the species, breed them in captivity, release them into the wild, and defend them from hunters, polluters, or others who would harm them. The wildlife owner would have to negotiate with landowners to protect habitat but may have designated rights to habitat on public lands. Private owners of the little Kern golden trout or upper Columbia River chinook salmon might own all of the fish of that species in a particular lake or watershed and would have the right to defend them from fishing, pollution, and, where their habitat occurs in waters of the state, habitat destruction. Private ownership of ocean fisheries has been a successful conservation tool in Iceland and New Zealand; this proposal merely extends this to other fish and wildlife.

Privatization or State Control

One state where privatization is essential is Nevada—85 percent of which is owned by the federal government, far more than any other state. Federal ownership has clearly inhibited growth in that state, particularly in the Las Vegas and Reno urban areas. The federal government should

accelerate efforts to privatize land for urban growth in Nevada. Moreover, the provision in the Southern Nevada Public Land Management Act of 1998 that dedicates 80 percent of revenues from land sales to the purchase of more land should be repealed. Such land purchases counteract the benefits of selling land for urban growth.

Turning federal lands over to the states offers little benefit: the states are just as poor land managers as the federal government. A Cato review of more than 150 state land agencies found that most of them suffer from the same financial problems and environmental conflicts as federal lands. The exceptions are state land trusts, and what makes them exceptional is not that they are state owned but that they are legally treated as fiduciary trusts.

Fiduciary Trusts

Fiduciary trusts are an institutional structure that can ensure long-term protection for nonmarketable resources while improving the fiscal management of the lands. A fiduciary trust is a legal construct based on hundreds of years of British and U.S. common law. A trust consists of four components:

- a "trustor," the person or entity who creates the trust;
- the "trustee," the person or people managing the trust;
- the "beneficiary," the person or people for whom the trust is managed; and
- the "trust instrument," the legal document that dictates how the trustor wants the trustee to manage the trust.

Trusts are significantly different from the bureaucracies that now manage federal lands. Trust law imposes strong obligations on trustees to preserve the productive capacity of trust resources, produce benefits for the trust beneficiaries, and fully disclose the costs and benefits of their actions. To create a trust, the trustor—Congress—is also obligated to give the trust a clear mission—something that many people would say today's federal land agencies lack.

With more than 1,000 forests, parks, refuges, and BLM districts, Congress need not turn all federal lands into trusts at one time. Instead, Congress can test the trust idea on selected administrative units. Tests can compare methods of governance, funding mechanisms, alternative geographic sizes, and other aspects of the trust concept. The results of the tests can point the way toward improving management on the remaining federal lands.

Conclusion

The 618 million acres managed by the Forest Service and Department of the Interior cost taxpayers more than $8 billion per year and continually produce major controversies and conflicts among users. Fiduciary trusts offer a way to solve these problems. Congress should test the trust system on selected national parks and other federal lands. If the tests are successful, Congress should reform all federal land agencies into a series of trusts. The results should satisfy those who care about natural environments and cultural resources, as well as those who care about fiscal responsibility.

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—Prepared by Randal O'Toole

52. Surface Transportation Policy

Congress should

- eliminate federal highway, transit, and other surface transportation programs; and
- devolve to the states and local areas full responsibility for highways and transit.

Failing that, Congress should

- fund state highways in block grants based on each state's land area, population, and road mileage;
- fund regional transit in block grants based on each metropolitan area's population and transit fare revenues;
- eliminate any conditions on the use of those funds, such as air pollution mandates or requirements for long-range planning;
- eliminate discretionary funds such as TIGER and New Starts;
- eliminate "flexible funds," that is, funds that can be spent on either highways or transit;
- eliminate requirements that states and metropolitan areas do long-range planning;
- encourage states and local areas to rely more heavily on user fees to fund all forms of transportation;
- ensure that any efforts to save energy or reduce greenhouse gas emissions are cost effective, that is, that state and local governments only invest in projects that can be shown to reduce energy consumption or greenhouse gas emissions at a lower cost than alternative projects; and
- reject proposals for mandatory vehicle-to-vehicle communications systems on all new cars.

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State legislatures should

- encourage experimentation with and licensing of self-driving cars, platooning, and other autonomous technologies;
- transition from gas taxes to mileage-based user fees; and
- ensure that all transportation is funded through user-pay systems.

Americans are the most mobile people on earth. The average American travels more than 14,000 miles per year by automobile, 1,900 miles by plane, nearly 200 miles by private bus, 170 miles by public transit, and 20 miles by Amtrak. The average European is less than half as mobile. Though average residents of the European Union may travel three times as many miles by bus and rail as Americans, they travel only about 40 percent as many miles by car and air.

Mobility drives the economy, giving Americans access to more productive jobs, better housing, lower-cost consumer goods, and greater social and recreational opportunities. Once considered the best in the world, America's transportation system was successful because, whether public or private, it was for the most part paid for out of user fees. That arrangement made transportation managers responsive to the needs of transportation users rather than to special interest groups.

Today, almost every transportation sector is distorted by government subsidies, and the cost of congestion has nearly quadrupled in the past 30 years. Rather than fix congestion, metropolitan planning organizations promote functionally useless projects—such as streetcars, light rail, and intercity rail—many of which actually make congestion worse. Rather than fix crumbling infrastructure, politicians prefer to spend money on new construction instead of maintaining existing systems. Rather than enabling mobility, political control enables social engineering, as government officials decide it is their job to nudge travelers toward some modes of transport over others for specious environmental, social, or other reasons.

Setting Priorities

Funding public or private transportation projects out of user fees forces a discipline: a project won't be built unless it has a good chance of paying for itself. The Interstate Highway System was successful because Congress

insisted that it be built out of user fees on a pay-as-you-go basis, which meant that if people didn't drive their cars, there would be no funds for construction.

Once the decision is made to subsidize transportation, no matter how justified it seems, the discipline that limits spending disappears. Projects that would be totally absurd under a user-fee system are funded despite increasing costs. For example, streetcars were a wonderful technology in the preautomobile world, and more than 1,000 American cities saw the construction of streetcar lines. But streetcars were rendered obsolete by more-flexible and lower-cost buses. By 1966, all but eight cities had replaced streetcars with buses. Yet, in recent years, we have seen a streetcar revival: cities are spending hundreds of millions of dollars on a slow, inflexible technology that can't move more than a tiny fraction of the number of people per hour as buses.

Light rail is another example. Its value was questionable in 1981 when San Diego replaced a profitable bus line with a money-losing rail line at a cost of around $10 million per mile (in today's dollars). By 2016, the average cost of light-rail lines being planned or constructed had grown to $160 million per mile, yet those lines can carry no more people than the San Diego line. Contrary to claims, neither light rail nor streetcars promote economic development; if anything, cities that build them tend to grow more slowly than cities that don't.

High-speed rail may have made sense in a society, such as Japan in the 1960s, where most travel was by low-speed rail. But the door-to-door convenience of autos outweighs the speed advantage of high-speed rail for short trips, while commercial aircraft are far faster than high-speed trains for long trips. In 1998, when California estimated that a Los Angeles–to–San Francisco high-speed rail line would cost less than $10 billion, University of California, Berkeley, economists calculated that it would cost more to move travelers by train than by air or auto. Today, the projected cost of that line exceeds $100 billion, yet the state still wants to build it.

The political emphasis on passenger travel also ignores the importance of freight, some 40 percent of which is shipped over highways. The diversion of billions of dollars of highway user fees to transit each year does little for passenger travel and nothing for freight, while the huge increase in highway congestion since transportation became politicized has been a nightmare for both shippers and commuters.

The only way to stop this waste is for Congress and the states to return to a user-pays system of transportation funding. Among other things, that means ending such discretionary funds as New Starts and Transportation Investment Generating Economic Recovery (TIGER) grants. Research by the Cato Institute and the Reason Foundation has shown that these funds are allocated politically, with a Democratic administration sending disproportionate shares to states and congressional districts represented by Democratic members of the House Transportation and Infrastructure Committee. Any federal transportation funds should be distributed using formulas based on factors such as population, land area, and the amount of user fees collected by local governments—not on political criteria.

Crumbling Infrastructure

Contrary to popular belief, not all infrastructure is crumbling. State highways, which are mainly funded out of gas taxes and tolls, are generally in good repair: the number of bridges rated "structurally deficient" and the average roughness of pavement are both steadily declining. City and county roads, which get more funding from general funds, tend to be in poorer condition.

Worst of all is transit infrastructure, which suffers from an $86 billion (and growing) maintenance backlog, mainly due to the poor condition of older rail transit lines. The Washington Metrorail system is a prime example. It is falling apart, and recent maintenance efforts will only temporarily relieve the problem. Metro's board knew as early as 2002 that the system would need billions of dollars' worth of maintenance upgrades, yet local and regional politicians decided instead to spend those billions building two additional lines. This is a predictable result of political control of the transportation system because politicians prefer to fund "ribbons, not brooms," that is, to fund new projects rather than maintain existing projects.

No transit agency that has built rail transit in the past 30 years has planned or budgeted for the inevitable rise in maintenance costs as rail infrastructure ages. A return to funding transportation out of user fees will give transport managers incentives to keep systems in a state of good repair so as not to lose revenues.

Transportation and the Environment

Automobiles and highways have been unfairly demonized as a source of almost every social ill imaginable. Some of these charges may have

made sense in 1970, when most cars were gas-guzzlers, air pollution darkened American skies, and highway deaths peaked at 55,000 per year.

Since then, cars have become far more energy efficient, while urban transit has become less energy efficient. In most urban areas, cars now use less energy per passenger mile than transit. In 2014, the only major transit systems more energy efficient than the average auto were in New York, Chicago, Washington, San Francisco–Oakland, Atlanta, Portland, and Honolulu.

Similarly, since 1970, total automotive air pollution has declined 85 percent despite a 175 percent increase in driving (which means pollution from the average car declined 95 percent). Further, highway fatalities per billion vehicle miles have declined by more than 75 percent. Today, light rail kills roughly twice as many people per billion passenger miles as cars do on urban highways and streets.

While technology has reduced the costs of driving, efforts to attract people out of their cars have failed. Since 1992, federal, state, and local governments have spent more than $350 billion (in 2015 dollars) on transit capital improvements—more than three-fourths of the inflation-adjusted cost of the entire Interstate Highway System. Two-thirds of those transit capital funds were spent on rail transit.

Despite that huge investment in rail, per capita transit usage declined by 5 percent while per capita urban driving grew by 15 percent. Transit carried less than 60 billion passenger miles of travel in 2014, while urban interstates alone carried more than 850 billion passenger miles. Transit's share of urban travel declined from 2 percent in 1990 to 1.7 percent in 2015. The biggest declines in transit's share of travel were in urban areas with rail transit, partly because rail transit is so costly that transit agencies often cannibalize the bus systems that carry most of their transit patrons.

Nor have land-use policies aimed at creating more compact urban areas proved successful. San Jose, for example, adopted an urban-growth boundary in 1974. The result has been to increase the San Jose urbanized area from fewer than 3,800 people per square mile in 1974 to more than 6,000 today. The city also built a 40-mile light-rail system. Yet transit's share of travel declined from 1.2 percent of passenger miles in 1982 (the earliest year for which data are available) to 0.8 percent in 2014.

These examples show that the solution to problems with the automobile is to make better automobiles, not to try to persuade people out of their cars. Yet President Barack Obama's first secretary of transportation openly

admitted that the administration's goal was to "coerce people out of their cars." Cato's review of long-range transportation plans for the nation's 70 largest metropolitan areas found that half relied on behavioral tools to solve transportation problems, even though some admitted those tools hadn't worked in the past. Many of these regions spend half or more of their transportation funds on transit systems that often carry as little as 1 or 2 percent of motorized passenger travel (and no freight).

Redefining User Fees

Most state highways are paid for out of gasoline tax revenues, but the gas tax has several defects: it does not adjust for inflation or for fuel-efficient cars, and—unlike a real user fee—it does not do anything to relieve congestion. Most cities and counties rely on general funds to pay for their roads. Oregon is experimenting with mileage-based user fees, which can potentially solve all of these problems. Other states should follow suit.

The Next Transportation Revolution

Since the republic was founded, the United States has been transformed by successive transportation revolutions, including steamboats, canals, steam trains, streetcars, and automobiles. We are on the verge of another such revolution: self-driving cars are likely to have at least as great an impact on American living and working patterns as Henry Ford's mass-produced automobile.

Many cars today have "advanced driver assistance systems," which help drivers control the speed and, in some cases, steering. Despite media reports of a fatal accident involving a Tesla with such systems, these aren't self-driving cars. True self-driving cars, which will be on the market by around 2020, will use extremely precise maps to define where the car can go and numerous sensors to give the car a 360-degree view of pedestrians, other vehicles, and other potential obstacles.

Self-driving cars will change how people view travel, allowing people to commute longer distances. They will also reduce congestion, allowing more people to live in urban centers. No one can predict all the implications of autonomous vehicles. So long-range planning makes no sense, and Congress should eliminate requirements for such planning. Major investments in transit infrastructure are also unwise, as shared, self-driving cars are likely to replace transit in all but a few major cities.

The National Highway Traffic Safety Administration has proposed mandating that all new cars incorporate vehicle-to-vehicle communications systems. Such a mandate (which is mainly favored by the manufacturers of such systems) would leave cars susceptible to hacking and would quash innovation in the development of new technologies. People who consult their smart phones or GPS for traffic reports are already using vehicle-to-vehicle communications. There is no need to mandate a single standard for such systems.

Conclusion

Because transportation is so vital to American life, it is important to make transportation investments where they will do the most to enhance mobility. The best way to ensure that result is to rely on user-pay systems.

There is little reason why a true user-pay system should require federal involvement. But to the extent that Congress remains involved in transportation issues, it should promote user-pay systems at the state and local level and take steps to ensure that state and local use of federal transportation funds is cost effective. That means, among other things, distributing funds based on performance standards, eliminating earmarks, and streamlining transportation planning.

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—Prepared by Randal O'Toole

53. Cultural Agencies

Congress should

- eliminate the National Endowment for the Arts;
- eliminate the National Endowment for the Humanities; and
- defund the Corporation for Public Broadcasting.

In a society that constitutionally limits the powers of government and maximizes individual liberty, there is no justification for the forcible transfer of money from taxpayers to artists, scholars, and broadcasters. If the proper role of government is to safeguard the security of the nation, by what rationale are its residents made to support exhibits of paintings, symphony orchestras, documentaries, scholarly research, and radio and television programs they might never freely choose to support? The kinds of things financed by federal cultural agencies were produced long before those agencies were created, and they will continue to be produced long after those agencies are privatized or defunded. Moreover, the power to subsidize art, scholarship, and broadcasting cannot be found within the powers enumerated and delegated to the federal government under the Constitution.

The National Endowment for the Arts (NEA), an "independent" agency established in 1965, makes grants to museums, symphony orchestras, individual artists "of exceptional talent," and organizations (including state arts agencies) to "encourage individual and institutional development of the arts, preservation of the American artistic heritage, wider availability of the arts, leadership in the arts, and the stimulation of non-Federal sources of support for the Nation's artistic activities." Among its more famous and controversial grant recipients were artist Andres Serrano, whose exhibit featured a photograph of a plastic crucifix in a jar of his own urine, and the Institute of Contemporary Art in Philadelphia, which

sponsored a traveling exhibition of the late Robert Mapplethorpe's homoerotic photographs. (Thanks to an NEA grantee, the American taxpayers once paid $1,500 for a poem, "lighght." That wasn't the title or a typo. That was the entire poem.) The NEA's fiscal year 2016 budget was $148 million.

The National Endowment for the Humanities (NEH)—with a FY16 budget of $148 million—"funds activities that are intended to improve the quality of education and teaching in the humanities, to strengthen the scholarly foundation for humanities study and research, and to advance understanding of the humanities among general audiences." Among the things it has funded are controversial national standards for the teaching of history in schools, the traveling King Tut exhibit, and the documentary film *Rosie the Riveter*.

The 49-year-old Corporation for Public Broadcasting (CPB)—with a FY16 budget of $485 million—provides money to "qualified public television and radio stations to be used at their discretion for purposes related primarily to program production and acquisition." It also supports the production and acquisition of radio and television programs for national distribution and assists in "the financing of several system-wide activities, including national satellite interconnection services and the payment of music royalty fees, and provides limited technical assistance, research, and planning services to improve system-wide capacity and performance." Some of the money provided to local public radio and television stations is used to help support National Public Radio (NPR) and the Public Broadcasting Service (PBS).

Note that the amount of arts funding in the federal budget is quite small. That might be taken as a defense of the funding were it not for the important reasons to avoid *any* government funding of something as intimate yet powerful as artistic expression. Also note how small federal funding is as a percentage of the total arts budget in this country. The NEA's budget is about 1 percent of the $17.2 billion contributed to the arts by private corporations, foundations, and individuals in 2014. According to Americans for the Arts, the nonprofit arts are a $135 billion industry. And the NEA says that arts and culture contribute $704 billion to the economy. Surely they will survive without whatever portion of the NEA's budget gets out of the Washington bureaucracy and into the hands of actual artists or arts institutions. Indeed, when the NEA budget was cut in 1995, private giving to the arts rose dramatically.

In 1995, Congress voted to phase out the NEA over three years. The 115th Congress should revive that commitment and also end federal

involvement with the National Endowment for the Humanities and the Corporation for Public Broadcasting.

Subsidies by the Poor to the Rich

Since art museums, symphony orchestras, humanities scholarship, and public television and radio are enjoyed predominantly by people of greater-than-average income and education, the federal cultural agencies oversee a fundamentally unfair transfer of wealth from the lower classes up. It's no accident that you hear ads for Remy Martin and "private banking services" on NPR, not for Budweiser and free checking accounts. Columnist Robert J. Samuelson called federal cultural agencies "highbrow pork barrel." Harvard political scientist Edward C. Banfield wrote, "The art public is now, as it has always been, overwhelmingly middle and upper-middle class and above average in income—relatively prosperous people who would probably enjoy art about as much in the absence of subsidies." Supporters of the NEA often say that their purpose is to bring the finer arts to those who don't already patronize them. But Dick Netzer, an economist who favors arts subsidies, conceded that they have "failed to increase the representation of low-income people in audiences." In other words, lower-income people are not interested in the kind of entertainment they're forced to support; they prefer to put their money into forms of art often sneered at by the cultural elite. Why must they continue to finance the pleasures of the affluent?

Corruption of Artists and Scholars

Government subsidies to the arts and humanities have an insidious, corrupting effect on artists and scholars. It is assumed, for example, that the arts need government encouragement. But if an artist needs such encouragement, what kind of artist is he? Novelist E. L. Doctorow once told the House Appropriations Committee, "An enlightened endowment puts its money on largely unknown obsessive individuals who have sacrificed all the ordinary comforts and consolations of life in order to do their work." Few have noticed the contradiction in that statement. As author Bill Kauffman has commented, Doctorow "wants to abolish the risk and privation that dog almost all artists, particularly during their apprenticeships. `Starving artists' are to be plumped up by taxpayers. . . . The likelihood that pampered artists will turn complacent, listless, and lazy seems not to bother Doctorow." Moreover, as Jonathan Yardley, the

Washington Post's long-time book critic, asked, "Why should the struggling young artist be entitled to government subsidy when the struggling young mechanic or accountant is not?"

Politicizing of Culture

James D. Wolfensohn, former chairman of the Kennedy Center for the Performing Arts, decried talk about abolishing the NEA. "We should not allow [the arts] to become political," he said. But it is the subsidies that have politicized the arts and scholarship, not the talk about ending them. Some artists and scholars are to be awarded taxpayers' money. Which artists and scholars? They can't all be subsidized. The decisions are ultimately made by bureaucrats (even if they are advised by artists and scholars). Whatever criteria the bureaucrats use, they politicize art and scholarship. As novelist George Garrett has said, "Once (and whenever) the government is involved in the arts, then it is bound to be a political and social business, a battle between competing factions. The NEA, by definition, supports the arts establishment." Adds painter Laura Main, "Relying on the government to sponsor art work . . . is to me no more than subjecting yourself to the fate of a bureaucratic lackey."

Mary Beth Norton, a writer of women's history and a former member of the National Council on the Humanities, argues that "one of the great traditions of the Endowment [for the Humanities] is that this is where people doing research in new and exciting areas—oral history, black history, women's history to name areas I am familiar with—can turn to for funding." When the NEH spent less money in the mid-1980s than previously, Norton complained, "Now, people on the cutting edge are not being funded anymore." But if bureaucrats are ultimately selecting the research to be funded, how cutting edge can it really be? How can they be trusted to distinguish innovation from fad? And who wants scholars choosing the objects of their research on the basis of what will win favor with government grant referees?

Similar criticism can be leveled against the radio and television programs financed by the CPB. They tend (with a few exceptions) to be aimed at the wealthier and better educated, and the selection process is inherently political. Moreover, some of the money granted to local stations is passed on to NPR and PBS for the production of news programs, including *All Things Considered* and the *NewsHour.* Why are taxpayers in a free society compelled to support news coverage, particularly when it is inclined in a statist direction? Robert Coonrod, former president of CPB, defends the

organization, saying that "about 90 percent of the federal appropriation goes back to the communities, to public radio and TV stations, which are essentially community institutions." Only 90 percent? Why not leave 100 percent in the communities and let the residents decide how to spend it? Since only 15 percent of public broadcasting revenues now come from the federal government, other sources presumably could take up the slack if the federal government ended the appropriation.

The fundamental objection to the federal cultural agencies is not that their products have been intellectually, morally, politically, or sexually offensive to conservatives or even most Americans. That has sometimes, but not always, been the case. Occasionally, such as during the bicentennial of the U.S. Constitution, the agencies have been used to subsidize projects favored by conservatives. The brief against those agencies would be the same had the money been used exclusively to subsidize works inoffensive or even inspiring to the majority of the American people.

Nor can the case against the cultural agencies be based on how much they spend. In FY16, a total of about $781 million was appropriated for the two endowments and the CPB, a mere morsel in a $4 trillion federal budget. The NEA's budget is about 0.1 percent of the total amount spent on the nonprofit arts in the United States.

No, the issue is neither the content of the work subsidized nor the expense. Taxpayer subsidy of the arts, scholarship, and broadcasting is inappropriate because it is outside the range of the proper functions of government. As such, it needlessly politicizes, and therefore corrupts, an area of life that should be left untainted by politics.

Government funding of anything involves government control. That insight, of course, is part of our folk wisdom: "He who pays the piper calls the tune." "Who takes the king's shilling sings the king's song."

Defenders of arts funding seem blithely unaware of this danger when they praise the role of the national endowments as an imprimatur or seal of approval on artists and arts groups. Former NEA chair Jane Alexander said, "The Federal role is small but very vital. We are a stimulus for leveraging state, local and private money. We are a linchpin for the puzzle of arts funding, a remarkably efficient way of stimulating private money." Drama critic Robert Brustein asks, "How could the NEA be `privatized' and still retain its purpose as a funding agency functioning as a stamp of approval for deserving art?"

The politicization of whatever the federal cultural agencies touch was driven home by Richard Goldstein, a supporter of the NEH, in a 1982

article about the struggle for control of the NEH in the Reagan administration. Goldstein pointed out,

> The NEH has a ripple effect on university hiring and tenure, and on the kinds of research undertaken by scholars seeking support. Its chairman shapes the bounds of that support. In a broad sense, he sets standards that affect the tenor of textbooks and the content of curricula. . . . Though no chairman of the NEH can single-handedly direct the course of American education, he can nurture the nascent trends and take advantage of informal opportunities to signal department heads and deans. He can "persuade" with the cudgel of federal funding out of sight but hardly out of mind.

The cudgel (an apt metaphor) of federal funding has the potential to be wielded to influence those who run the universities with regard to hiring, tenure, research programs, textbooks, and curricula. That is an enormous amount of power to have vested in a government official. Surely, it is the kind of concentration of power that the Founding Fathers intended to thwart.

Separation of Conscience and State

We might reflect on why the separation of church and state seems such a wise idea to Americans. First, it is wrong for the coercive authority of the state to interfere in matters of individual conscience. If we have rights, if we are individual moral agents, we must be free to exercise our judgment and define our own relationship with God. That doesn't mean that a free, pluralistic society won't have lots of persuasion and proselytizing—no doubt it will—but it does mean that such proselytizing must remain entirely persuasive, entirely voluntary.

Second, removing religion from the sphere of politics enhances social harmony. Europe suffered through the Wars of Religion, as churches made alliances with rulers and sought to impose their theology on everyone in a region. Religious inquisitions, Roger Williams wrote in 1644, put towns "in an uproar." If people take their faith seriously, and if government is going to make one faith universal and compulsory, then people must contend bitterly—even to the death—to make sure that the *true* faith is established. If, instead, we enshrine religion in the realm of persuasion, there may be vigorous debate in society, but there won't be political conflict. People can deal with one another in secular life without endorsing the private opinions of their colleagues.

Third, competition produces better results than subsidy, protection, and conformity. "Free trade in religion" is the best tool humans have to

find the nearest approximation to the truth. Businesses coddled behind subsidies and tariffs will be weak and uncompetitive, and so will churches, synagogues, mosques, and temples. Religions that are protected from political interference but are otherwise on their own are likely to be stronger and more vigorous than a church that draws its support from government.

If those statements are true, they have implications beyond religion. Religion is not the only thing that affects us personally and spiritually, and it is not the only thing that leads to cultural wars. Art also expresses, transmits, and challenges our deepest values. As the managing director of Baltimore's Center Stage put it, "Art has power. It has the power to sustain, to heal, to humanize . . . to change something in you. It's a frightening power, and also a beautiful power. . . . And it's essential to a civilized society." Because art is so powerful, because it deals with such basic human truths, we should not entangle it with coercive government power. That means no censorship or regulation of art. It also means no tax-funded subsidies for arts and artists, for when government gets into the arts funding business, political conflicts ensue. Conservatives denounce the NEA for funding erotic photography and the PBS for broadcasting *Tales of the City,* which has gay characters. (*More Tales of the City*, which appeared on Showtime after PBS ducked the political pressure, generated little political controversy.) Civil rights activists make the Library of Congress take down an exhibit on antebellum slave life, and veterans' groups pressure the Smithsonian to remove a display on the bombing of Hiroshima. An NEA official asks grant recipients to support a White House initiative. To avoid political battles over how to spend the taxpayers' money, to keep art and its power in the realm of persuasion, we would be well advised to establish the separation of art and state.

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—Prepared by Sheldon Richman and David Boaz

54. Special-Interest Spending and Corporate Welfare

Congress should

- end direct subsidies for businesses, such as grants and loans;
- end indirect subsidies for businesses, such as research and export promotion programs; and
- end regulations and trade barriers that favor certain businesses at the expense of consumers and other businesses.

When considering policy issues, federal lawmakers should have the broad public interest in mind. Unfortunately, that is not how the policy process often works in practice. Many programs are sustained by special-interest groups that gain narrow benefits at the expense of the general public. This chapter discusses why this occurs and focuses on one manifestation of the problem—business subsidies or "corporate welfare."

Special Interests Trump the General Interest

In an idealistic view of democracy, legislators always put average citizens first. They study alternatives, work toward a consensus, and pass legislation that has broad support. They also ensure that their actions are allowable under the U.S. Constitution.

The problem with this "public interest theory of government" is that it explains very little in the real world. Congress often enacts ill-conceived laws that benefit narrow groups at the expense of most citizens. Many federal programs harm the overall economy, and they are only sustained because interest groups support them.

Basic political incentives are to blame. To secure reelection, members of Congress try to gain the support of special-interest groups, particularly those that are important in their states. Members receive campaign support

from interest groups and may even look forward to a post-congressional job with one of them. Furthermore, members get bombarded with seemingly convincing messages from interest groups about why subsidy programs are needed.

Members believe that they are doing the right thing when they support subsidies for their states or favored industries. What they don't seem to appreciate is that narrow subsidies nearly always make the nation as a whole worse off through higher taxes and economic distortions. The benefits created by subsidies are often visible and tangible, but the larger costs are diffused across millions of taxpayers or consumers.

Table 54.1 shows how special-interest bills can gain majority support even if they are bad for the nation overall. A five-person legislature votes on a program that provides nationwide benefits of $40 but costs taxpayers $50. Assuming that legislators vote in the narrow interests of their states, the program garners a majority vote. The key to passage is that the benefits are more geographically concentrated than the costs. The legislation is a political success, but it is a failure for the nation because it costs more than it is worth.

Logrolling, or vote trading, makes special-interest provisions even easier to pass. Party leaders or committees bundle together many narrow provisions that benefit particular states and interest groups. Such bills often pass, even though the specific provisions do not have majority support on their own.

Table 54.2 shows how two subsidy programs can pass the five-person legislature, even though both have higher costs than benefits. Neither A nor B has majority support, and each would fail if voted on separately. So Sanders, Schumer, and Shelby agree to bundle the two programs in a

Table 54.1
Majority Voting Does Not Ensure That Benefits Outweigh Costs

Legislator	Vote	Benefits Received by Constituents	Taxes Paid by Constituents
Sanders	Yea	$12	$10
Schumer	Yea	$12	$10
Shelby	Yea	$12	$10
Sessions	Nay	$ 2	$10
Shaheen	Nay	$ 2	$10
Total	**Pass**	**$40**	**$50**

Table 54.2
Logrolling Allows Passage of Narrow Subsidies

	Program A		Program B		
Legislator	Benefits Received by Constituents	Taxes Paid by Constituents	Benefits Received by Constituents	Taxes Paid by Constituents	Vote on Bill That Includes A and B
Sanders	$15	$10	$ 8	$10	Yea
Schumer	$15	$10	$ 8	$10	Yea
Shelby	$ 4	$10	$20	$10	Yea
Sessions	$ 3	$10	$ 2	$10	Nay
Shaheen	$ 3	$10	$ 2	$10	Nay
Total	**$40**	**$50**	**$40**	**$50**	**Pass**

single bill. They logroll. The two programs get approved, even though both of them impose a net cost on society.

Logrolling has been around since the 19th century. One early example was omnibus river and harbor bills, which sprinkled Army Corps of Engineers projects across many states to ensure passage. From the beginning, people observed that such bills included low-value projects that did not have broad support. In 1835, Tennessee Rep. Davy Crockett criticized the "log-roll" system, and in 1836, Virginia Rep. John Patton complained that a river and harbor bill being debated was a "species of log-rolling most disreputable and corrupting." In the early 20th century, scholar Chester Collins Maxey lambasted logrolling, arguing that it resulted in half the projects in omnibus bills, such as river and harbor bills, being "pure waste."

The magnitude of federal spending is much greater today, and so the logrolling problem is worse. Nearly all the spending in the $4 trillion budget stems from huge bills that bundle together many diverse provisions. Members have neither the time nor the incentive to rigorously critique individual programs in these large bills. So there is little debate about the real value of most federal spending.

Corporate Welfare

Corporate welfare is one manifestation of the special-interest spending problem. The budget contains many subsidies that aid some businesses at the expense of taxpayers and the overall economy. The government

spends about $100 billion annually on corporate welfare, according to a 2012 Cato study. That amount includes direct grants and loans to companies, as well as indirect aid for industries.

Here are some of the corporate welfare programs in the federal budget:

- **Farm subsidies.** The U.S. Department of Agriculture (USDA) spends about $25 billion a year on an array of subsidies for farm businesses. Roughly a million farmers receive the subsidies, but the payments are tilted toward the largest producers. The largest 15 percent of farm businesses receive more than 85 percent of the subsidies. USDA data show that the average income of farm households was $134,164 in 2014, which was 77 percent higher than the average of all U.S. households.
- **Rural subsidies.** The USDA subsidizes rural businesses through the Rural Housing Service, the Rural Utilities Service, and the Rural Business-Cooperative Service. The programs, which cost about $6 billion a year, subsidize financial institutions, housing developers, utilities, and many other types of businesses—from car washes to clam harvesters.
- **Energy subsidies.** The Department of Energy spends more than $4 billion a year on subsidies for conventional and renewable energy. The subsidies include loans and grants to energy companies, and indirect business support such as industry research.
- **Small business subsidies.** The Small Business Administration provides subsidized loans and loan guarantees to businesses, which costs taxpayers about $1 billion a year. Other federal agencies favor small businesses through preferential procurement rules and other methods.
- **Export subsidies.** The federal government provides aid to exporters through the Department of Commerce, the Foreign Military Financing program, and the Export-Import Bank. The latter agency provides loan guarantees and other aid to some of the nation's largest corporations, such as Boeing and General Electric.
- **Aviation subsidies.** The federal government spends billions of dollars a year on the operation of the air traffic control system and grants to commercial airports. But reforms in Canada and Great Britain show that airports and air traffic control can be separated from the government and self-funded.
- **Earned income tax credit (EITC).** The $70 billion EITC is usually thought of as a subsidy for low-income workers, but the program also subsidizes businesses. The EITC is designed to increase labor supply,

but to the extent that it does, it reduces market wages for low-income workers. In effect, the program allows businesses to hire workers at a lower cost, with federal taxpayers picking up part of the wage bill.

This chapter focuses on spending for corporate welfare, but the government also subsidizes businesses through other means. International trade restrictions protect certain businesses at the expense of consumers and businesses that use imported goods. And in numerous industries, regulations protect established firms from competition by creating barriers to entry.

Another example of corporate welfare through regulation is the Renewable Fuel Standard, which requires that transportation fuels contain biofuel, primarily corn-based ethanol. The standard is a subsidy to corn farmers and the renewable fuels industry. It costs motorists about $10 billion a year, raises food prices, and does not benefit the environment.

What's Wrong with Corporate Welfare?

The above examples illustrate that corporate welfare comes in many flavors. "Crony capitalism" is another name for the problem. These subsidies have many negative effects:

1. They harm taxpayers. A 2012 Cato report found that the federal government spends about $100 billion annually on corporate welfare. Repealing the spending would save every household in the nation an average of about $800 a year.

2. They harm consumers and businesses. Corporate welfare aids some businesses, but it harms other businesses and consumers. Federal import barriers on sugar, for example, raise sugar prices and cost U.S. consumers about $2 billion a year. Some U.S. food companies that use sugar in their products have moved their production abroad to access lower-priced sugar.

3. They create an uneven playing field. Businesses receiving federal subsidies have an unfair advantage over unsubsidized competitors in their industries. Corporate welfare can also have unfair effects on businesses in other industries. As an example, the Export-Import program has subsidized jet purchases by foreign airlines, but that has given the foreign airlines an advantage over U.S. airlines that pay the full prices for their jets.

4. They duplicate private activities. Corporate welfare often duplicates activities that are already available in private markets, such as insurance, loans, marketing, and research. USDA's Risk Management Agency, for example, says that its mission is to help farm businesses "through effective,

market-based risk management tools." But if these services are "market-based," then Congress can end this $8 billion agency and let the private marketplace provide the tools.

5. They foster corruption. Corporate welfare fosters political corruption as businesses looking for handouts try to gain the support of politicians and federal officials. A 2011 *Washington Post* investigation into green energy subsidies was titled, "Solyndra: Politics Infused Obama Energy Programs." The investigation found that the business people behind firms receiving green subsidies were often Obama campaign donors, that Solyndra's corporate decisionmaking was driven by political considerations, and that a major Democratic fundraiser and frequent visitor to the Obama White House, George Kaiser, held a one-third stake in Solyndra through his family foundation. Federal taxpayers lost half a billion dollars on the failed solar company, Solyndra.

6. They weaken the private sector. Corporate welfare draws talented people away from productive pursuits and into wasteful subsidy activities. Companies that take government subsidies often become weaker, less efficient, and distracted from serving their customers. They take on riskier projects, they make decisions divorced from market realities, and they substitute lobbying for innovation. Federal export subsidies, for example, induced Enron Corporation to partake in failed overseas projects that helped pull the company down. And in chasing federal green subsidies, the utility Southern Company has spent more than $6 billion on a disastrous "clean coal" power plant that has doubled in cost.

7. They damage trust in government and business. Public opinion polls show plunging support for politicians and big businesses over the years. Gallup polls find that just one-fifth of Americans have "confidence" in big business, and they find that about three-quarters of people think there is "widespread corruption" in American government. The recent rise of populist politicians partly stems from the feeling that the "system is rigged" in favor of special interests, such as big businesses. Business and political leaders would garner more respect if they cut their ties to each other by ending corporate welfare.

Conclusions

Corporate welfare and other special-interest subsidies should be abolished. But reforms will only happen if congressional leaders make it a priority and members of Congress understand that the nation would gain from overall restraint. In Washington, subsidies have grown in an

environment where members perceive that it is "every man for himself" in securing favored spending.

Structural budget reforms would help Congress make tradeoffs. A balanced-budget requirement and a cap on the annual growth in total spending are mechanisms that would encourage restraint. Special commissions to downsize particular parts of the budget might also work, as they did with multiple rounds of military base closings.

Congress has the ability to end corporate welfare and other subsidy programs. But the job would be easier if Congress made structural reforms to limit special-interest pressures. It would also be made easier if more constituents pressured members to cut subsidies, particularly subsidies to members' own states.

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—Prepared by Chris Edwards

REGULATION

55. Toward a New and Improved Regulatory Apparatus

Congress should

- abandon wholesale efforts to jettison regulations that are already in place; and
- instead, pass legislation to improve the analysis of major federal regulations by removing the task of creating Regulatory Impact Analyses from the executive branch agencies that write the regulations and authorizing a new, independent agency to do the analyses.

Few people paying attention are pleased with the current state of regulatory oversight. On the one hand, progressives argue that the Office of Information and Regulatory Affairs (OIRA), the entity within the Office of Management and Budget (OMB) tasked with reviewing agency rules, stifles consumer and environmental protections and places too much emphasis on costs. Liberal entities also complain about the strictures of the regulatory oversight process, which they claim slow down necessary and sometimes urgent regulatory reforms and merely substitute one set of analyses for another.

Conservatives, on the other hand, protest that OIRA is little more than a political arm of the White House that is loath to push back on even egregious rules issued by cabinet agencies and has no ability to oversee independent agencies such as the Federal Communications Commission or Consumer Financial Protection Bureau. As a result, agencies merely go through the motions to ensure that their proposed regulations pass a cost-benefit test.

Currently, executive branch agencies that propose "economically significant" regulations (meaning those with an impact on the economy estimated

to be over $100 million) must submit a Regulatory Impact Analysis to OIRA that demonstrates the estimated benefits exceed potential costs. The process of analyzing the costs and benefits for proposed regulations and acting on this information should be straightforward. But White House politics and the nation's entrenched regulatory apparatus have made it anything but.

The most egregious problem with the current system is that the entities performing the cost-benefit analysis are the agencies issuing the regulations, which creates an enormous conflict of interest. The economists at the Environmental Protection Agency understand full well that their task is to deliver a cost-benefit analysis that demonstrates the regulation being considered is efficacious—no matter what. Promotions, raises, professional plaudits, and the potential for future jobs all depend on the implementation of regulations.

Conservatives and libertarians who have worked at OIRA have lamented this problem and have proposed various ways to fix it. Some have argued for greater congressional oversight; others have suggested that OIRA, which is frequently rolled by the agencies themselves or by the White House in whatever bureaucratic tussle they engage in, be given more power.

The optimal solution to this decades-long problem of regulatory overreach is to create a new entity that would be tasked with doing the cost-benefit analysis of regulations issued by the executive branch agencies as well as all independent federal agencies. Creating such an entity would do much more good than continued unrealistic efforts to reform current regulatory policy.

Regulatory Rollback Is Hopeless and Unnecessary

Despite the acrimony among the Republicans who ran for president in 2016, there was actually a fair amount of agreement when it came to their policy proposals. For instance, nearly every candidate put together a major tax reform proposal, none of which differed much from one another save for the size of the revenue loss. For what it's worth, the candidate who proffered the biggest cut happened to be the one who gained the nomination.

The candidates also agreed on the need for some sort of regulatory "reform." The reform plans were usually as vague as the tax plans, but they typically consisted of a promise to do a comprehensive analysis of current regulations to determine whether they pass a cost-benefit test based

on a revised set of metrics. Those that do not pass muster would then be repealed.

The government has undoubtedly issued a plethora of regulations that would not have survived an objective comparison of their costs and benefits at the time they were issued. Agencies are adept at putting their thumbs on the scale to achieve their goals (which is invariably to issue more regulations). When that isn't sufficient, they do their best to avoid the scrutiny of cost-benefit analysis altogether. For instance, the Treasury Department recently gave its "emergency" regulations on corporate inversions to OMB's Office of Information and Regulatory Affairs, the office tasked with determining whether rules do indeed pass a cost-benefit test, a mere two hours before Treasury was to make its determination. Another trick that regulatory agencies use is to diminish the estimated cost impact of a regulation to the limits of reason to ensure that it ends up below the $100 million threshold that triggers an automatic review by OMB.

However, the campaign promises to reform regulatory policy are not only as unrealistic as a $10 trillion tax cut, but they would do little to reduce compliance costs and save economic resources. The unfortunate reality is that no economic gain will be achieved from reviewing and repealing rules that have been in force for any period of time. And the notion that any administration can—or should—wipe the slate of existing regulations is not only politically unrealistic, but unwanted.

The problem is that the costs to businesses from existing, flawed regulations have already been spent and cannot be recaptured, for the most part. Power plants have installed the coal scrubbers; gas stations have reinforced storage tanks; human resource departments have redone their software; and other agencies affected by other regulations have already made their investments in human or physical capital or whatever else it took to conform to the regulations. In most instances, a repeal saves them close to nothing.

Even if the original regulation did not make sense, repealing the edict usually makes little more sense. In some instances, repeal could disrupt the entire market, and not in a good way. For instance, if a regulation that required a costly investment to comply was repealed, new entrants could appear, unburdened with the need to make the costly investment themselves, and drive out the incumbents. In that case, nothing would be gained because the new entrants would have nearly the same operating costs as the incumbents they drove out, but we would lose whatever benefits resulted from the original regulation, such as lower emissions.

While it is a valid point that our government does too much to help entrenched businesses at the expense of businesses yet to be conceived, repealing a costly rule that has already been met and has a modicum of benefits amounts to sheer sabotage.

In 2011, OIRA administrator Cass Sunstein announced plans to have federal agencies do a rigorous analysis of rules that could be repealed in a cost-effective way. As a result, a handful of inconsequential regulations were set aside, the most famous of which was one that required spills from milk trucks to be treated as if they were hazardous waste. It was a welcome change to be sure, but it represented a minor cost savings for an event that happens infrequently. Sam Batkins, director of regulatory analysis for the American Action Forum, estimated that the savings from repealing that regulation would be less than $1 million a year.

We can and should improve regulatory policy, and there are ways to do so without merely undoing the rules of the previous administration. The most important change would be to remove the agency proposing a regulation from doing the cost-benefit analysis used to determine its worthiness. The current system rests on an enormous conflict of interest, akin to letting a parent be the judge at a beauty pageant. A separate entity within the executive branch, funded with money clawed back from the agencies, should perform the cost-benefit analysis instead. While it is fair to ponder whether such an office could eventually be subject to regulatory capture itself, it would doubtless be better than the system in place now. The new entity—and not the agency issuing the regulation—should also determine whether a rule should be construed as "major" and thus subject to the cost-benefit analysis critique.

Potential Regulatory Reforms

A number of reforms of the regulatory process have been suggested in the last few years. One idea that received majority support in the House is the Regulations from the Executive in Need of Scrutiny (REINS) Act. The REINS Act would require Congress to hold an up-or-down vote on all major regulations before final promulgation. This proposal is the inverse of the Congressional Review Act currently in place, under which Congress must affirmatively vote to repeal a regulation after an agency issues a final rule.

Some scholars believe that Congress is ill-equipped to deal with every new federal regulation. John Morrall, a longtime OIRA veteran, is wary of more legislative oversight, fearing it would do nothing to make regulatory

analysis less political, but merely more explicit. Given the current political environment in Congress, it is unlikely the administration and Congress will agree to the sort of comprehensive regulatory reform envisioned by the REINS Act. Reforming OIRA, however, and instituting more procedural checks could garner sufficient bipartisan support.

OIRA 2.0

Leaders on Capitol Hill have advocated for a more powerful OIRA. For instance, Sen. John Barrasso (R-WY) has suggested six specific steps to reform the office:

1. OIRA needs to review not only executive branch regulations, but also those of independent agencies.
2. Every significant rule should have a complete cost-benefit analysis independent from politics, which could mean an analysis done by another entity.
3. OIRA needs greater transparency such that those affected by a regulation have an opportunity to exchange views with the government.
4. OIRA needs to "call a regulation a regulation" and make agency "guidance" extremely rare, forcing agencies to go through the formal process for every significant regulatory change it seeks.
5. OIRA needs to be proactive in seeking out and eliminating duplicative or contrary rules across government.
6. OIRA should continually seek rules to eliminate and constantly check the effectiveness of rules.

Perhaps the strongest case for extending OIRA's power over independent agencies is that the market influence of these regulators, to some extent, has outpaced cabinet-level agencies. The Federal Communications Commission now regulates the Internet, which is close to 5 percent of the nation's gross domestic product, and its regulatory bill has grown larger in the last four years.

The new world of financial regulations under the Dodd-Frank Act also begs for more analysis. The legislation spelled out more than 400 rules, and a majority of them will likely never monetize costs or be subjected to a comprehensive cost-benefit analysis. The role of independent agencies has outgrown the 1980s, and regulatory oversight should evolve with those agencies.

A Congressional Budget Office for Regulations

Perhaps the most popular idea for regulatory process reform is to create a new agency dedicated to independent review of major regulations. Such an agency would avoid the moral hazard problem engendered by having agencies doing their own cost-benefit analyses.

There is no reason that this agency would have to cost the government more money: OMB could simply claw back the money the agencies currently allocate to the task of economic analysis and use that to fund the new agency. Some have suggested that to save money and improve the scope of its work, some of the regulatory analysis could be handled by outside economists in a government version of an academic peer review.

Where this entity would be housed would matter and is worth debating. Some have suggested that this new agency be the regulatory equivalent of the Congressional Budget Office and placed within the legislative branch. Others would prefer that it be an executive branch agency. And others have suggested that it operate as an appendage to OIRA.

Former OIRA administrators do not like the idea of having the new entity housed inside the executive branch. They note that the current problem OIRA faces is that political considerations invariably trump economic reasoning and that proximity to the White House, both literally and figuratively, makes that more likely to occur. Presumably, a new entity would be subject to the same pressures if it were housed in an office within the OMB, as OIRA currently is.

Fiscal conservatives on Capitol Hill are cool to the idea of a Regulatory Budget Office. They doubt it could be done without costing more money than the current arrangement, and they would prefer a reform that gives them more oversight over the regulatory process. As a result, if this were to pass, political exigencies would probably require such an entity to be an entity of Congress akin to the Congressional Budget Office.

One drawback to this plan is that a distinct office of regulatory oversight would not solve all the myriad problems with our current regulatory activities. Given the very nature of who goes into government, it is hard to see how we could keep the office from being captured by the agencies and their pro-regulatory agendas. However, the fact that the denizens of OIRA continue to display independent thinking decades after its creation does inspire some hope that it would be a long-term improvement over the current arrangement.

Lessons from History

No matter what a new administration does to reform the issuance of regulations, it is important to recognize that the regulatory battle will never end. Regulators regulate. It is why they joined the agency that employs them; how they get promotions, plaudits from interest groups, and interesting jobs in the future; and how they exert a modicum of power. Their bias will always be to issue new regulations, and even the most even-handed bureaucrat will have every incentive in the world to push forward on a regulation. We will always need independent entities to monitor our regulatory bureaucracy, both inside and outside of government.

Students of government and policy can learn a lot from studying the 1986 tax reform. Although it was not perfect, it created a tax code that removed many of the special interest deductions, exclusions, and credits that made the tax code maddeningly complicated and forced tax rates to be high in order to collect sufficient revenue to (less than wholly) fund our government. Since passing the 1986 reform, Congress has steadily picked apart the code; now we've reached the point at which our economy is saddled with a tax code less conducive to economic growth than it was before the 1986 reform.

The regulatory apparatus can never get us to such a copacetic state as the tax code's post-1986 honeymoon. Given the nature of our dynamic $18 trillion economy, the government must constantly adjust the nation's regulatory framework as new businesses develop, old ones decline, and our citizens' priorities change. Not only will we never be able to achieve any sort of short-term regulatory nirvana, but also any procedural reforms Congress does manage to achieve are likely to be perpetually under attack from various special interests. Those special interests will fight vigorously to nudge, shove, or browbeat the regulatory bureaucracy to help move new and expanded regulations through the maw of government.

Thus, it is important to recognize that we will never be "done" with regulating. As our regulators do their business, the best we can hope for are regulators cognizant of their biases, an administration that's willing to remove some of the inherent biases in the regulatory framework when they become apparent, and a Congress that's eternally vigilant about regulatory overreach. Because each of these is difficult to attain, we should also do more to encourage a rigorous outside review of our agencies' regulatory activities—separate from the actions of industry. Sadly, this component is lacking at present. Trade associations and large corporations may find it worth their while to invest in the human capital necessary to

defend their business. And the environmental nonprofit sector has a wealth of resources available to spend on its agenda and a generation of men and women who see protecting the environment as a secular religion and well worth the sacrifice of pay and free time to achieve. But there is a paucity of scholars willing and able to study the regulatory actions of the government in an objective way.

Congress's detachment from most regulatory activity has resulted in a lack of the expertise that is needed to intelligently weigh in on most regulatory activities. This lacuna also makes it difficult for Congress to think cogently about what can and should be done to improve the regulatory apparatus. As a result, its rhetoric to that effect has usually been more fodder for the consumption of voters and donors than a precept for future action.

The Current Broken System

There are myriad problems with how the regulatory apparatus currently functions. Agencies invariably go dark before presidential reelection campaigns and then unleash a torrent of new regulations after the vote, regardless of the outcome. In 2016, the last year of Barack Obama's presidency, we saw an almost unprecedented pace of regulatory activities from the Department of Labor, with the Environmental Protection Agency not far behind. There were also an amazing number of regulations that are thought to cost just under $100 million, the threshold at which they must undergo stricter scrutiny by OIRA.

Again, there is no silver bullet that can fix the problems that plague our regulatory apparatus. The basic constraint is that the federal government tends to attract people who believe that the government is the solution to the problems that ail the economy; and the economists who perform cost-benefit analyses in the government fully comprehend the incentives that incline them to justify any and all regulations that come their way. What's more, the political might that any White House can exert on an agency can behoove them to act with political expediency. In both Democratic and Republican administrations, that almost invariably entails doing more, not less.

An entirely new entity that performs cost-benefit analysis cannot change who goes into government or change the inherent incentives in place, but it can insulate those who perform this task from a modicum of political and agency pressure to conform. It might not amount to a complete and permanent fix of our regulatory environment, but it would be a dramatic

improvement over the status quo and a necessary (but not sufficient) ingredient in a process that would work better for taxpayers and consumers.

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—Prepared by Ike Brannon

56. Monetary Policy

Congress should

- replace the Federal Reserve's dual mandate with a single stable-spending mandate;
- require the Fed to adopt an explicit rule consistent with fulfilling that mandate;
- reform the Fed's operating framework, so that emergency Fed lending, either to banks or to nonbanks, is unnecessary;
- prohibit the Fed from engaging in direct lending;
- broaden the Government Accountability Office's powers to "audit" the Fed, especially by allowing the agency to investigate violations of the Fed's monetary rule and extraordinary open-market purchases;
- expedite the "normalization" of monetary policy, by prohibiting the Fed from paying banks to hold excess reserves, and by calling for it to shrink its balance sheet; and
- take steps to establish a "level playing field" between the dollar and either actual or potential alternative currencies.

The Federal Reserve (the Fed) is the ultimate source of the nation's most liquid financial assets: bank reserves and circulating currency. As such, its overarching responsibility is to prevent liquidity shortages from causing unemployment or otherwise disrupting economic activity, while avoiding the unwanted inflation and unsustainable booms that result from excessive liquidity creation.

Replace the Dual Mandate with a Single Stable-Spending Mandate

The Fed currently operates under a mandate from Congress, calling for it to pursue both maximum employment and stable prices. This "dual"

mandate can be interpreted so as to be at least roughly consistent with responsible liquidity management. But the dual mandate's ambiguity prevents it from serving as a clear statement of the Fed's mission, as understood by Congress, much less as a device for assuring that the Fed adheres to that mission.

A single mandate to achieve *either* maximum employment *or* stable prices is not a good solution. A simple maximum-employment mandate might be understood as calling on the Fed to create liquidity to boost employment even when doing so would aggravate the boom-bust cycle or generate undesirable inflation, while a price stability mandate might compel it to stabilize prices even when doing so means countering price movements reflecting underlying changes to the overall availability of goods and services rather than excessive or deficient money creation.

Instead, Congress should replace the dual mandate with a single "stable spending" mandate, calling on the Fed to maintain a stable, though steadily rising, level of spending on goods and services or, in other words, a stable dollar value of national income. By creating sufficient reserves and currency to stabilize spending, the Fed would avoid unemployment linked to liquidity shortages, while also avoiding unsustainable booms and general inflation caused not by genuine changes in goods' overall scarcity, but by excessive supplies of money and credit.

Require the Fed to Abide by an Explicit Monetary Rule

Monetary policy works best when monetary authorities have a clear mission and can be trusted to stick to that mission. Otherwise, the public's fear that the authorities will veer from their assigned task can itself add to the challenge of avoiding monetary instability.

Both experience and theory show, however, that mere promises on the part of the authorities are not sufficient to gain the public's confidence. To make such promises credible, authorities must be held accountable for failing to keep them. Accountability can best be achieved by requiring monetary authorities to adopt explicit monetary policy rules, consisting of specific statistics they plan to target and sanctions to be applied if they fail to meet these targets.

Designing a rule appropriate to a stable-spending mandate is, fortunately, very straightforward. The simplest option is for Congress to require that the Federal Reserve commit itself to maintaining a specific growth rate for nominal gross domestic product (GDP)—a popular measure of total spending. The specific rate, as well as other details, might be left to

Fed officials to decide, but most experts would place the desirable growth rate of nominal GDP somewhere in the range of 3 to 5 percent. Meaningful sanctions for violating the rule could consist of financial penalties imposed on members of the Federal Open Market Committee—the committee within the Federal Reserve System that determines the direction of monetary policy. For example, members could be assigned very modest base salaries with bonuses dependent on their success in meeting their targets.

Create a Flexible Open-Market Framework

At present, the Federal Reserve can add to the nation's monetary reserves in two ways. One is by purchasing financial assets in the open market ("open-market purchases"). The other is by directly lending money to banks or (using its emergency lending powers) to nonbanks.

Open-market operations have the advantage of minimizing the Fed's involvement in the *allocation* of credit: the Fed creates a certain amount of new reserves but lets private-market arrangements handle their distribution among different firms. In contrast, when it engages in direct lending, and especially when it targets its loans at specific firms, the Fed becomes more heavily involved in allocating credit, thereby increasing the risk of credit being distributed inefficiently. The Fed's tendency to employ its direct lending powers to support insolvent firms, including those that it considers too big (or "systemically important") to fail, is particularly troublesome.

The ability of open-market operations to get credit where it is most needed is presently limited by the Fed's system of buying only certain kinds of assets, from only a limited number of financial institutions. Normally these limitations are not important; new liquidity, once exchanged for other assets at market prices, tends to make its way to the firms most in need of it. During extreme emergencies, however, normal private-market mechanisms for redistributing liquid reserves among solvent firms can break down. The claim that such a breakdown occurred during the 2008 financial crisis supplied a rationale for unprecedented Fed lending to both banks and nonbanks during that episode.

To make any similar resort to direct lending unnecessary in the future, Congress should make way for "flexible" open-market operations. Specifically, it should require the Fed to (1) conduct open-market purchases, not only with the firms it presently deals with, but also with all financial institutions that presently have access to the Fed's discount window; (2) extend the list of securities it stands ready to purchase to include all securities that are presently accepted as collateral for its discount-window

loans; and (3) replace its traditional auctions with "product mix" auctions, like those now employed by the Bank of England for some of its open-market purchases. Product-mix auctions would allow eligible counterparties with different sorts of eligible collateral on hand to compete more effectively for available Fed credit.

Prohibit Federal Reserve Direct Lending

Because a flexible open-market framework can provide for both the ordinary and the extraordinary liquidity needs of all solvent financial enterprises, having such a framework would make direct Fed lending unnecessary, even during emergencies. Nor should lending to systemically important financial institutions (SIFIs) be an exception: sound SIFIs could take part in the Fed's liquidity auctions; insolvent SIFIs could safely be left to fend for themselves as long as firms that might suffer collateral damage from their failures were themselves able to compete for emergency funds. Congress should therefore prohibit the Fed from engaging in direct lending, including both discount window lending to banks and Section 13(3) lending to nonbanks.

The reforms outlined here would allow a single open-market facility to supply both ordinary and emergency liquidity, making it unnecessary for the Fed to serve as a "lender of last resort." Instead, by attending to its duty to manage the total supply of liquidity in a manner consistent with achieving its stable-spending target, the Fed would automatically meet any emergency liquidity needs. Ordinarily, open-market operations would resemble traditional operations, with purchases largely—if not entirely—confined to Treasury securities, and dealings limited to specialized security dealers. During emergencies, however, other solvent firms facing temporary liquidity shortages would find it worthwhile to compete for new Federal Reserve dollars, using assets not normally employed for the purpose, in an auction specifically designed to ensure an efficient outcome and, especially, to prevent scarce funds from being assigned to undeserving firms.

Audit the Fed's Performance

The Federal Reserve, as an agency empowered by Congress to maintain a liquid financial system, should, like all other government agencies, be accountable to Congress. In practice, that means Congress must, at the very least, be able to monitor the Fed's success in performing its official

duties and report on whether it has employed necessary and proper means in performing them.

The Government Accountability Office (GAO) exists precisely for the purpose of evaluating, on behalf of Congress, the performance of government agencies. As a nonpartisan agency itself, the GAO is able to provide evaluations uninfluenced by partisanship, in response to specific requests. The Fed's current exemption from all GAO inquiries pertaining to its open-market operations and its dealings with foreign central banks thus represents an anomaly—one that Congress ought to correct. If extended to the reforms proposed here, the exemption would amount to a virtual ban on any GAO evaluation of the Fed's performance of its duties, since those duties would be performed exclusively by means of various open-market operations.

Fed officials, among others, complain that, by allowing the GAO to investigate ("audit") Federal Reserve undertakings, Congress would pave the way for unwanted congressional interference with the Fed's setting of monetary policy. Such complaints are misguided for several reasons. First, GAO investigations simply provide information to Congress; they do not alter Congress's ability to challenge Federal Reserve policies. Second, Congress, having empowered the Fed in the first place, has the right, and indeed the duty, to assess the Fed's performance. Admittedly, Congress is capable of interfering unduly with the Fed's conduct of monetary policy. But the best way to avoid such unwanted interference is by clarifying the Fed's mission and responsibilities. By doing so, Congress would rule out politically motivated attempts to creatively "reinterpret" the Fed's responsibilities without having to exempt the Fed from ordinary congressional oversight.

Normalize Monetary Policy

Between 2007 and 2014, the Fed's balance sheet increased fourfold as a result of both unprecedented levels of direct Fed lending and the various rounds of large-scale Fed asset purchases known as "quantitative easing." The expansion was accompanied by an almost equal increase in banks' holdings of excess reserves—that is, reserves exceeding minimum required levels—owing, at least in part, to the Fed's decision to pay interest on bank reserves, including excess reserves, beginning in October 2008.

These and other extraordinary developments have led to major changes in both the Fed's monetary control procedures and its overall involvement in credit allocation. The crisis having now passed, both the Fed's vastly

increased credit "footprint" and the uncertain reliability of its novel monetary control procedures have become objects of great concern.

Fed officials concede the desirability of eventual monetary policy "normalization," meaning a return to precrisis monetary control arrangements and a reduced Fed balance sheet. But so far the Fed has neither taken any substantial steps in the direction of normalization nor committed itself to a definite deadline for doing so. Allowing the Fed to delay normalization indefinitely risks having it continue to play a much larger than desirable part in credit allocation. It also risks having the Fed choose to contain inflation, such as might follow a revival of bank lending, by raising the interest rate on reserves enough to quash the revival, instead of selling assets to reduce its own contribution to the money supply.

To avoid such risks, Congress should compel the Fed to begin regular sales of the securities—especially mortgage-backed securities—it acquired during the crisis. The schedule of minimum sales should ensure that the Fed can rid itself entirely of the less liquid securities in its portfolio within seven years. To avoid having such sales undermine monetary control, the Fed must be allowed to offset them, when necessary, by purchasing ordinary (short-term) Treasury securities.

Finally, to complete as well as expedite the normalization process, Congress should stipulate the phase-out of both interest payments on banks' excess reserves and the Fed's "overnight reverse-repo" facility, which serves as a means for making similar payments to various other financial institutions, including money market mutual funds. To the extent that it contributes to a revival of bank lending and investment, the phase-out of interest on excess reserves would allow the Fed to dispose of mortgage-backed securities more rapidly, or at least to resort to offsetting Treasury security purchases less frequently.

Establish a Level Currency Playing Field

Congress could further encourage the Fed to manage the dollar responsibly by establishing a level playing field between the U.S. dollar and its potential rivals. This move would also make it easier for U.S. citizens to use alternative means of payment when doing so makes them better off.

To level the field on which the dollar competes with other potential means of payment, Congress should repeal 31 U.S. Code § 5103, which makes Federal Reserve notes and Treasury coins "legal tender for all debts, public charges, taxes, and dues." Specific performance of contracted obligations should instead be the sole remedy for breach-of-debt contracts,

no matter what means of payment they specify. Congress should also prohibit any taxation of private exchange media, whether physical or digital, that would make using such media more costly than using dollar-based monies. Among other things, that would mean exempting alternative exchange media from either sales or capital gains taxes.

Finally, Congress should repeal those parts of U.S. Code, Title 18, that make it illegal to make, possess, or circulate private metal coins or tokens that resemble coins. Although Congress has good reason to prohibit the actual counterfeiting of official coins, such counterfeiting is separately and adequately dealt with by 18 U.S. Code § 485.

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—Prepared by George Selgin

57. Financial Regulation

Congress should

- repeal the Dodd-Frank Act;
- short of repeal, make major modifications to Titles I, II, and X of Dodd-Frank, which cover the Financial Stability Oversight Council, orderly liquidation authority, and the Consumer Financial Protection Bureau;
- wind down Fannie Mae and Freddie Mac without establishing a new guarantee for mortgage risk, and reform the Federal Housing Administration;
- roll back recent expansions in federal deposit insurance;
- repeal the Community Reinvestment Act of 1977; and
- eliminate the Exchange Stabilization Fund.

From its earliest days, the American system of banking regulation has been characterized by state and federal authorities that bestow market power on banks through restrictions on the entry of competing firms into the market and through limitations on acquisitions and diversification. These entry and structural barriers have created economic rents for existing market players and resulted in a more fragile banking system. Examples of such restrictions include limitations on the geographical and product diversity of bank portfolios.

The relative fragility of the U.S. banking sector, a direct result of the restrictions, led to the creation of government safety nets, such as the Federal Reserve and the Federal Deposit Insurance Corporation. Countries that have avoided these types of restrictions on geographical and product diversity, such as Canada and Australia, have exhibited greater stability and adopted government safety nets for their banking systems much later, if at all. Moreover, entry barriers have created economic rents or excess

profits (a point that has not been ignored by politicians). A significant portion of modern banking regulation involves the redistribution of those excess profits, though, of course, the amount is difficult to measure. We are quickly reaching—and may have already passed—the point at which the redistribution of rents and the costs of other regulations outweigh the benefits that banks receive from both the safety net and entry barriers.

Any credible attempt to reform our system of banking regulation must address all these factors. A free, competitive, and healthy banking system is one with few barriers to entry, no safety net, and no redistribution of wealth/income. As long as safety nets are extensive, the resulting moral hazard will necessitate prudential regulation. Since prudential regulation is inferior to market discipline, an extensive bank safety net almost certainly will lead to a financial crisis.

Dodd-Frank

The Dodd-Frank Act expands the bank safety net and continues using the banking system as an avenue to redistribute wealth. Dodd-Frank will likely increase both the frequency and severity of financial crises by further reducing market discipline and increasing the political control of our financial system. The best solution would be to repeal the entire Dodd-Frank Act. Short of that, policymakers should focus on Titles I, II, and X.

Title I—Financial Stability Oversight Council

The Financial Stability Oversight Council (FSOC) is tasked with labeling companies, including nonbank financial companies, as "systemically important"—that is, "too big to fail." That role gives regulators significant supervisory power over all large financial institutions and creates an implied government backstop for firms so labeled. To end the perception of too-big-to-fail, we must end the use of such labeling by government.

Title II—Orderly Liquidation Authority (OLA)

Orderly liquidation authority (OLA) empowers the federal government, via the Federal Deposit Insurance Corporation (FDIC), to take over and "resolve" failing nonbank financial companies and bank holding companies. That authority creates confusion and uncertainty in a crisis and codifies the potential for the regulators to discriminate between different classes of creditors or rescue creditors. The use of OLA is at the discretion

of the Treasury secretary, which means it is unlikely to be used, particularly if the Treasury can rely on other sources of funding to keep failing institutions afloat. All of the necessary tools to implement the resolution of a large systemic bank or other financial company can be achieved with some modifications to the bankruptcy code, such as creating a new Chapter 14 in the bankruptcy code.

Title X—Consumer Financial Protection Bureau

The Consumer Financial Protection Bureau (CFPB) promises to do for nonbank financial companies what the federal government has done for banks: subject them to political pressure to follow noneconomic lending standards. The CFPB also attempts to do to other forms of finance what the federal government has done to the mortgage market, namely, turn them into a source of systemic risk. While structural changes, such as putting the agency under a five-member commission, would be modest improvements, they fall short of correcting the worst flaws of the CFPB. Thus, full repeal is needed along with repeal of the various "protection" statutes mentioned earlier. Short of abolishing the CFPB, Congress should (1) place the CFPB within the congressional appropriations process, (2) change its governance structure to a board rather than a director, (3) direct the CFPB to define "abusive" with a notice-and-comment rulemaking process, (4) require cost-benefit analysis for all CFPB rules, (5) have a chief economist report directly to CFPB leadership, (6) remove CFPB involvement with the FDIC, and (7) require CFPB to include safety and soundness considerations in its rulemakings.

Mortgage Finance

Given their prominent role in the financial crisis, Fannie Mae and Freddie Mac should be wound down over a brief number of years, no more than six. That end can be accomplished by using the receivership mechanism in the Housing Economic and Recovery Act of 2008 (HERA). As HERA does not abolish their charters, Congress should sunset those charters, while also setting a path to reduce loan limits, increase down payments, and raise guarantee fees for Fannie Mae and Freddie Mac. The remainder of our financial system has sufficient capacity to absorb the activities of Fannie Mae and Freddie Mac and do so in a manner with significantly less leverage. Essentially, Fannie Mae and Freddie Mac are avenues for banks to transfer mortgage credit risk from themselves to the

taxpayers. Such a transfer increases the amount of credit risk in the system, so those guarantees should be ended and not replaced. If policymakers believe there is some economic value in the companies, their charters could be converted to bank holding companies, subjecting them to the same competitive and regulatory environment as commercial banks.

Federal mortgage subsidies, predominantly in the form of Federal Housing Administration (FHA) guarantees, have long led the mortgage market in the direction of riskier underwriting standards. FHA has paved the way for both very low down-payment and low borrower-credit lending. A significant portion of FHA loans would not be made by any lender under the current terms without a government guarantee. That means those loans should not be made as they leave the taxpayer and the financial system at considerable risk. While the long-term goal should be the elimination of FHA, Congress in the interim should (1) immediately require borrowers to make a 5 percent cash down payment, (2) require FHA to allow only reasonable debt-to-income ratios of no more than 30 percent, (3) restrict loans to borrowers with a credit history no worse than a 600 FICO equivalent, and (4) require in-person prepurchase counseling for FHA borrowers with FICO equivalents between 600 and 680. Eligibility should also be limited to borrowers whose incomes do not exceed 115 percent of the state median income.

Federal Deposit Insurance

Discussions of moral hazard during the financial crisis generally focused upon the incentives of management and equity holders, yet far more moral hazard results from a reduction in monitoring by creditors. The most important creditor class for a commercial bank is depositors, who provide about 75 percent of funding for the total banking system (the rest coming from equity and borrowed funds). Substantial academic literature demonstrates that depositors are capable of monitoring banks and that government-provided deposit insurance reduces that monitoring and results in greater risk-taking by banks.

The public interest would be best served if Congress were to reduce federal deposit insurance coverage to the pre–savings and loan crisis limit of $40,000. To further the goal of reducing systemic risk, Congress should also limit the total deposit insurance coverage of any one bank to 5 percent of total insured deposits. Given the current size of the fund, over $6 trillion, such a limit would imply that no one bank would hold more

than $350 billion in insured deposits. Currently, four banks are above that level.

As of first quarter 2015, the FDIC backs $6.3 trillion in deposits. That represents about 60 percent of outstanding U.S. domestic deposits. That also represents a 50 percent increase—more than $2 trillion—in insured deposits since year-end 2007 and almost a doubling of insured deposits from 2003 to 2015. Part of the increase was due to the Federal Deposit Insurance Reform Act of 2005, which raised the limit for deposit insurance for retirement accounts to $250,000. Congress should repeal those provisions of the 2005 act. Within the Troubled Asset Relief Program (TARP), Congress also raised the deposit insurance cap to $250,000 until January 1, 2010. Dodd-Frank made permanent the coverage expansion contained in the TARP.

Dodd-Frank's section 335 extends the 2005 retirement coverage limit of $250,000 to all accounts. According to the Federal Reserve's Survey of Consumer Finance, the median U.S. household holds $4,100 in a checking account. For the fewer than 10 percent that hold certificates of deposit, the median holding is $16,000. A cap of $40,000 (the pre–savings and loan crisis limit) would more than adequately cover the vast majority of U.S. households, while also greatly improving market discipline on U.S. banks. Even the typical (median) retirement account, not all of which are held at banks, is under $60,000.

The holdings of deposits are also highly concentrated. For instance, a fourth of all deposits are held by the wealthiest 1 percent of households. The top 10 percent of households hold 67 percent of all deposits. The wealthiest households also, on average, have considerable nondeposit sources of wealth. Even with significantly reduced deposit insurance coverage, middle- and low-income families could still be completely protected.

The argument behind expanding deposit insurance is that it reduces panics or bank runs. That may well be true in the short run, yet it comes at the cost of a tremendous reduction in market discipline. A World Bank study across more than 150 countries found that, all else equal, those countries with more generous deposit insurance schemes suffered more frequent banking crises. Similar results hold for the United States, as various academic studies have found that U.S. uninsured deposits provide substantial monitoring of bank health. The related decline in market discipline that results from deposit insurance has been documented across time and differing regulatory structures. Few relationships in economics have been found in so many different settings as the link between expanded deposit insurance and bank instability.

Community Reinvestment Act of 1977

A variety of statutes are intended to encourage banks either to make loans they would not otherwise make or to make loans available on terms they would not have made otherwise. Many of these statutes add considerable uncertainty to the lending process by giving borrowers an avenue to escape their obligations (or litigate) in the event of nonmaterial violations of these federal laws. The result is often to force lenders toward average cost pricing, such that better quality borrowers cross-subsidize poor-credit borrowers. These statutes are sometimes "justified" on the basis of the safety net benefits that banks receive from the government. Congress should roll back that safety net and repeal the Community Reinvestment Act (CRA).

CRA was passed to nudge banks into making loans to less creditworthy borrowers within their service areas. The law was enacted at a time when local banks did restrict the supply of loans due to their local market power. Initially designed as a "process-oriented" measure, in the 1990s, CRA began to resemble a quota system for lending. But, if anything, the recent crisis demonstrated an abundance of credit, rather than a shortage. CRA now represents a transfer from banks and higher-credit borrowers to lower-credit borrowers. Economist Jeffrey Gunther also found evidence that increased CRA activity comes at the expense of bank safety and soundness. Accordingly, the transfers inherent in CRA may well end up coming from the taxpayer. The act should be eliminated.

Exchange Stabilization Fund

Housed within the Treasury Department, the Exchange Stabilization Fund (ESF) was created to manage the gold–dollar parity, an activity that was abandoned decades ago. At this point, the ESF largely serves as a $100 billion slush fund for the Treasury. In the absence of outright elimination of the fund (the preferred option), significant limitations should be placed upon Treasury's power to use it. For example, the ESF should be used only to provide temporary, fully collateralized liquidity to solvent institutions. Treasury should not be entitled to use the fund to obtain equity stakes in, provide guarantees for, or otherwise assist insolvent institutions. Congress would also serve the public interest by prohibiting the use of the ESF to provide direct assistance to financial institutions; that is, the ESF could be better targeted to its intended purpose: exchange rate stability.

Conclusions

America continues a slow, weak recovery from the financial crisis. The legislative response to the crisis, most particularly the Dodd-Frank Act, has largely ignored the drivers of the crisis, leaving our financial system and economy as vulnerable as ever. To add insult to injury, financial regulatory reform postcrisis has greatly extended both explicit and implicit government guarantees of financial market risk taking, making future crises all the more likely. Our financial regulatory system is in dire need of wholesale reform. The proposals offered here are a starting point for such efforts. Additional reforms to impose market discipline and reduce political interference with our financial system are also needed if we are to achieve both robust economic growth and financial stability.

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—Prepared by Mark Calabria

58. Securities Regulation

Congress should

- repeal all legislation and regulations that mandate public disclosures relating to the purchase and sale of securities;
- replace those laws if necessary only with legislation that has been shown to actually promote price discovery or deter fraud without undue cost;
- extend the provisions of the IPO on-ramp in Title I of the JOBS Act of 2012 to all companies making an initial public offering;
- impose the terms of Section 404 of the Sarbanes-Oxley Act only on companies that have demonstrated insufficient internal controls;
- authorize public companies to use the offering exemption under Regulation A;
- define any off-exchange offering as "nonpublic" and therefore exempt from registration, and open all such offerings to investment from any investor regardless of wealth; and
- create a de minimis exemption for any offering of less than $500,000.

The world benefits from the innovations brought to market by the companies that develop new medical treatments, safety features, communication technologies, and other products and services that make modern life as safe and comfortable as it is. These companies, both those in the United States and many based abroad, rely on the U.S. capital markets to fund their work. Capital markets exist to funnel resources to their best use. When functioning properly, the markets ensure that companies with the best ideas and best business models will attract the most resources.

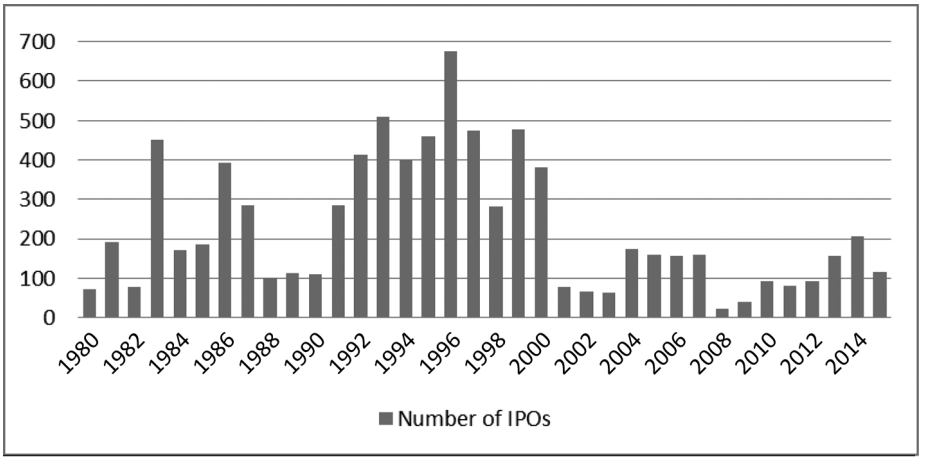
Regulation, however, can snarl these processes, leading companies to waste resources complying with inefficient or even counterproductive rules—resources that would otherwise have been employed improving lives. Over the roughly 100 years since the introduction of government-directed securities regulation, the securities laws and implementing rules have needlessly encumbered and often profoundly distorted the proper functioning of the capital markets. Those who advocate for increased regulation typically invoke the need for improved "investor protection" or, since the 2008 financial crisis, "financial stability." But many of the existing rules, at best, have no bearing on investor protection and, at worst, harm investors by limiting the amount of risk (which includes the opportunity for gain) they may take on. Even rules that may promote investor protection—by, for example, reducing the risk of fraud—are rarely evaluated to determine the harm they may pose to the greater society. Such rules may be reducing the ability of companies to bring life-saving products to market or limiting growth, leading to lower employment levels and impaired economic growth overall.

Existing regulation of registered securities should be dramatically pared back. Ideally, each exchange would set the rules for what disclosures are required for listed securities. Investors interested in the kind of protection afforded by mandated disclosures could restrict themselves to investing in the securities on the exchanges whose rules they find best suited to their needs. To the extent that such extensive change is not possible and federally mandated disclosures continue, these should be only the minimum needed to deter fraud and promote price discovery. No disclosure should be required unless it has been shown that it affirmatively promotes price discovery or deters fraud, and that the burden it places on all parties is justified by the benefit it imparts. Specific recommendations for regulations that should be repealed follow below, but these are, for the most part, just the most egregious examples. The entire disclosure structure is ripe for overhaul.

The Decline of the IPO and Effects on Wealth Inequality

The U.S. capital markets are the envy of the world. Deep, liquid, and transparent, they have historically attracted investment from all parts of the globe. But since 2000, the number of companies opting to go public has been in decline. It is true that the nearly 700 initial public offerings (IPOs) that marked the peak of the dot-com heyday in 1996 may not be our benchmark. But even leaving out the boom years in the late 1990s,

Figure 58.1
Number of IPOs, 1980–2015



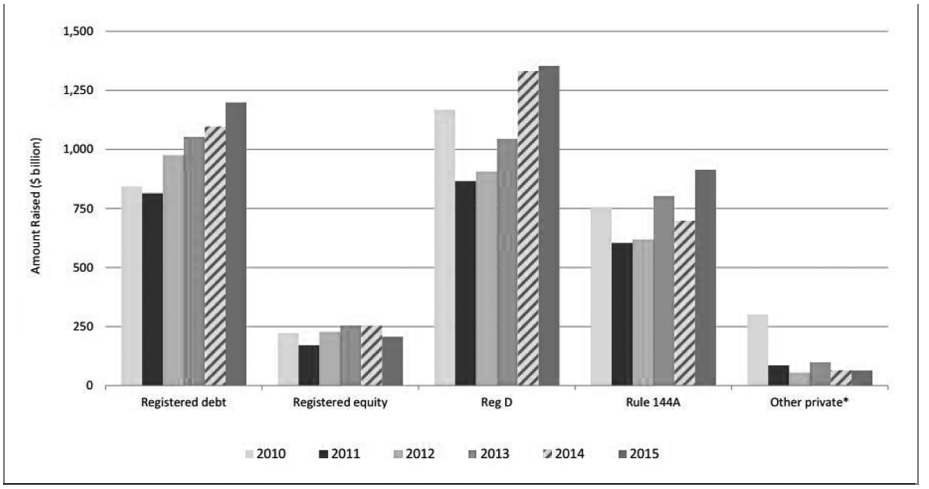
SOURCE: Jay Ritter, "Initial Public Offerings: Updated Statistics," University of Florida, March 2016, Table 15.
NOTE: IPO - inital public offering.

recent years have been anemic, averaging about 110 per year in the years 2001 through 2015 (see Figure 58.1). Because private investments are limited principally to institutions and wealthy individuals, the decline in IPOs contributes to wealth inequality, allowing only those who are already wealthy to share directly in companies' most explosive early growth.

It is worth noting that the IPO decline has not been caused by negative factors alone. For example, accessing private investment has become easier since the 2012 passage of the Jumpstart Our Business Startups (JOBS) Act. As Figure 58.2 illustrates, the capital raised through private offerings dwarfs the amounts raised through public (i.e., registered) offerings. However, it is clear that the drop in IPOs cannot be solely attributed to companies freely choosing to raise only private capital. Corporate leaders express frustration at both real and perceived burdens imposed on private firms, and scholars commonly cite increased regulation as one of the main reasons for the decline in IPOs.

Congress passed the Sarbanes-Oxley Act nearly 15 years ago. It is time to revisit this legislation, evaluate its effects on the economy, and strip out those portions that have served principally as an anchor, weighing down the economy and impeding its growth. It may indeed be time to repeal the act in its entirety.

Figure 58.2
Public vs. Private Capital Raising, 2010–2015



SOURCE: Scott Bauguess, Rachita Gullapalli, Vladimir Ivanov, and Anzhela Knyazeva, "Private Securities Offerings post-JOBS Act," Securities and Exchange Commission, PowerPoint Presentation, February 25, 2016. *Other private includes Section 4(a)(2) offerings.

The JOBS Act of 2012 provided a useful first step, exempting smaller companies from Sarbanes-Oxley's controversial Section 404 provisions for a period of time following an IPO. Section 404 requires the management of public companies to report on the adequacy of internal controls—those procedures and internal rules that ensure the company is, among other things, in compliance with regulations and that financial information is likely to be accurate—and requires the company's auditor to attest to management's assessment. This process is costly and therefore the JOBS Act, to reduce barriers for companies considering an IPO, provides certain exemptions from these requirements. There has been no indication that this exemption has led to increased corporate criminality. These exemptions should, at a minimum, be made available to all companies making an IPO. Additionally, Section 404 requirements should be imposed only after a company has shown that it has insufficient internal controls, not against all companies. Companies that can competently manage their own operations without running afoul of the law should be permitted to do so without government intervention.

Such regulatory relief would likely entice more companies to pursue IPOs and restore some of the market's lost vitality. It would also pave the way for additional review and repeal, allowing the law to be pared

back to only those components that have proven effective, if any are found to exist.

Halting the Expansion of the Current Disclosure Regime

In recent years, many activists have seized on public companies' mandatory disclosures as a means of promoting causes entirely unrelated to the purposes of these disclosures. That sets a dangerous precedent. Congress should repeal rules currently in place and commit to enacting no future legislation with similar rules.

The federal securities laws are a disclosure regime. Instead of requiring that offerings be approved by the Securities and Exchange Commission (SEC) as "fair, just, and equitable to the investor" as many state-level "merit review" regimes require, the Securities Act of 1933 and the Securities Exchange Act of 1934 require only that issuers provide a certain level of disclosure to the public as part of registering an offering for public sale. The scope of these disclosures has long been understood to encompass only information for which there is "a substantial likelihood that the disclosure . . . would have been viewed by the reasonable investor as having significantly altered the `total mix' of information made available." That is to say, information should be disclosed if it would help an investor determine the appropriate price for the investment, given its potential returns.

The 2010 Dodd-Frank Act included a number of rule-making requirements motivated by activists' interests and not investor protection. The most notorious, the "conflict minerals" rule, mandates that public companies disclose whether any of certain minerals used in their products were sourced from specific geographic areas. The motivation behind the disclosure was, according to the SEC, congressional "concerns that the exploitation and trade of conflict minerals by armed groups is helping to finance conflict in the Democratic Republic of the Congo and is contributing to an emergency humanitarian crisis." The sentiment is noble, but it should not lead Congress to resort to, in the words of one former commissioner, "hijacking" existing regulatory regimes. A second, similarly misguided new rule requires public companies to disclose the ratio of the chief executive's pay to that of the company's average worker. Activists are currently working to add disclosure of political and other types of contributions to the list of disclosures.

Such disclosure requirements present two problems. The first and most pressing is that, if the SEC's disclosure regime becomes entirely untethered

from its original, price-discovery function, it can be bent to any purpose at all. Furthermore, it sets a precedent for hijacking other disclosure regimes throughout the federal government. Americans should feel secure that any disclosures the government requires are carefully cabined to encompass only that information directly related to the legislation's initial intent.

Second, these disclosures often have unintended consequences. Any disclosure by a public company carries the risk of litigation if the statement is found to be either false or missing key information. Because of the difficulty in accurately tracing the manufacturing chain for minerals sourced in a low-infrastructure country like the Congo, many companies have simply stopped buying from producers in that region. That decision is harmful to the very people the rule was meant to help because it starves the region of desperately needed industry and investment. It is easy to imagine similar consequences arising from similarly misguided rules.

Congress should delineate clearly the scope of disclosures that the SEC may require, tying them tightly to the type of financial and risk-based disclosures originally contemplated by the 1933 and 1934 acts. It should also repeal those sections of Dodd-Frank that directed the SEC to promulgate the conflict minerals and pay-ratio disclosure rules, and direct the SEC to repeal the relevant implementing regulations.

Advantages of the Mini-IPO

Title IV of the JOBS Act provided much-needed relief for issuers seeking to use the Regulation A exemption for smaller-scale offerings. The exemption from registration requirements had fallen almost entirely out of use; in 2011, the year before the JOBS Act was signed into law, only one Regulation A offering was completed. But though the JOBS Act changes have shown promise, they do not go far enough. Congress should direct the SEC to extend federal preemption to all Regulation A offerings and all secondary market transactions in Regulation A–issued securities, and should eliminate the restriction that makes Regulation A available only to nonpublic companies.

In a 2012 report, the Government Accountability Office found that one of the principal reasons Regulation A had fallen out of use was the considerable burden imposed by state-level requirements. Public offerings registered with the SEC are exempt from state registration requirements, as are any private offerings conducted pursuant to Regulation D. This preemption has been instrumental to Regulation D's popularity. In issuing implementing regulations for the JOBS Act's changes to Regulation A,

the SEC provided federal preemption for a subset of Regulation A offerings. But it is difficult to understand why some Regulation A offerings may proceed without state registration whereas others may not. Some states have banded together to create streamlined state registration process, dubbed "coordinated review," to reduce the burden of state-level compliance. Whether coordinated review reduces the burden is beside the point, however, if state-level registration still provides less benefit than the cost incurred to comply. The North American Securities Administration Association, the state securities regulators' industry group, has failed to explain how a two-level review process for Regulation A offerings provides any benefit to investors.

State-level regulation presents other problems as well. Although securities sold pursuant to a Regulation A offering are, from a federal perspective, freely tradable in the secondary market, state regulation puts such sales in jeopardy. Currently, restrictions remain at the state level on how a registered broker–dealer can handle these securities. Removing those restrictions on secondary trading would make the securities more liquid.

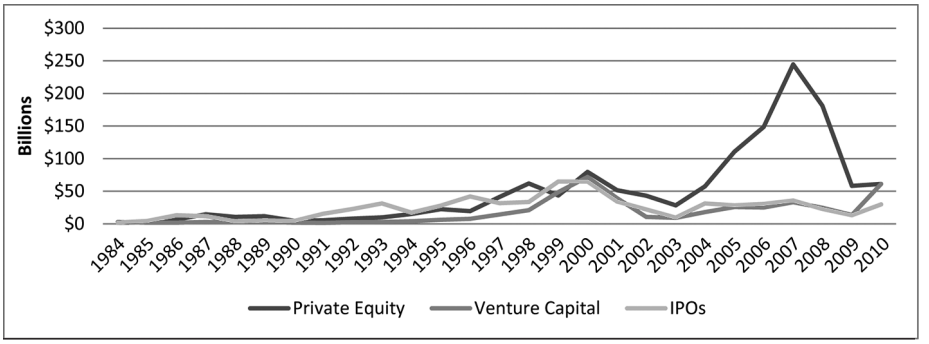
In addition, only nonpublic companies can make offerings through Regulation A. This restriction is illogical. Regulation A is a scaled-down version of a public offering, with limits on the amount a company can raise and, in some cases, on the amount investors can invest. The rationale for these limitations is that Regulation A reduces the disclosures required of the issuer. But if the issuer is a public company, it is already making the substantial and regular disclosures required of public companies. If the disclosures required under Regulation A are sufficient for an offering of that size, even without additional issuer disclosures, it is unclear why a company that makes *more* disclosures should be barred from using the exemption.

To the extent that issuers are turning away from the public markets, there is a need for attractive options that incorporate public investment. Regulation A mixes a light regulatory touch with investment opportunities for both retail and accredited investors, while maintaining provisions aimed at investor protection. Congress should ensure that its post–JOBS Act resurgence is fully supported by granting full federal preemption for all Regulation A offerings and opening Regulation A to public issuers.

The New Private Offering

Since the 1980s, private offerings have become increasingly popular with issuers and investors alike (see Figure 58.3). Private offerings, which include those made through private equity firms and venture capital firms

Figure 58.3
Private Equity and Venture Capital Fund Commitments and IPO Dollars Raised, 1984–2010



SOURCE: Jay Ritter, "Initial Public Offerings: Updated Statistics," University of Florida, March 2016, Table 1A; Gregory Brown et al., "What Do Different Commercial Data Sets Tell Us about Private Equity Performance?" SSRN Working Paper, December 21, 2015, Table 5.
NOTE: IPO - inital public offering.

(the latter defined chiefly by their focus on young, high-growth companies), are characterized by their lack of required disclosures, making them both cheaper to issue and less transparent to competitors. Most are offered under Regulation D, a 1982 regulation that allows private offerings an exemption from state-level registration requirements. Although private offerings can be a boon for many companies, participation is restricted to certain investors. Currently, with very few exceptions, only individuals with more than $200,000 in annual income (or $300,000 jointly with a spouse) or assets in excess of $1 million not including primary residence, and certain institutions may invest directly in private offerings. These restrictions, especially when paired with reduced IPO volume, can exacerbate wealth inequalities. Congress should open investment in private offerings to all investors, allowing investors themselves the freedom to choose between higher-disclosure public offerings and less-regulated private offerings.

Most private offerings use the safe harbor provided by Regulation D—in particular, Rule 506 of Regulation D. Rule 506 allows an issuer to raise an unlimited amount of money without registering either the company or the offering with the SEC, but it places restrictions on who may buy the securities and how the securities may be presented to potential investors. Issuers typically restrict their sales to accredited investors (for the most part, institutional investors, certain high-level company insiders, and individuals

who meet a specified wealth threshold) since offering the securities to nonaccredited investors triggers disclosure requirements.

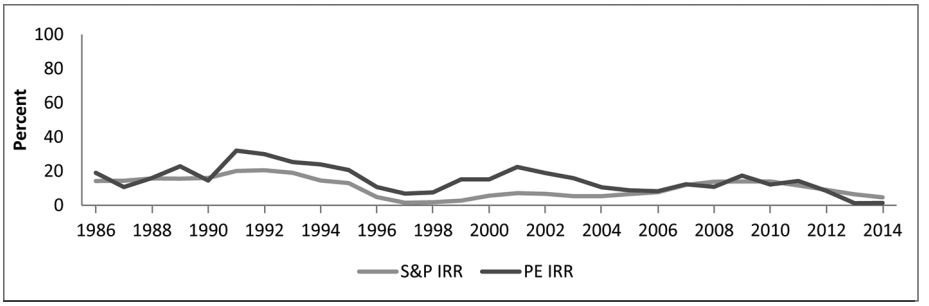
Currently, the wealth and income thresholds stand at more than $1 million in assets, excluding the primary residence, or more than $200,000 in annual income for the most recent two years, or more than $300,000 jointly with one's spouse for the most recent two years, with the expectation in either case that the investor will continue to earn the same amount in the future. A recent SEC report estimates that 10 percent of American households qualify for accredited investor status.

The current focus on the wealth of the individual investor as a determiner of private offering status has created a regime in which sophisticated investors are arbitrarily barred from investing in certain offerings purely because they lack wealth, and investor protection has become a matter of protecting investors not from fraud but from bad investment decisions. It is to lawmakers' credit that federal securities laws are a disclosure regime in which any offering may be made to the public if the issuer provides the right disclosures. But an approach to investor protection that seeks to protect investors from poor choices subverts that regime, making the SEC the judge of who is and is not fit to invest. Although the federal regulator still does not conduct merit review of offerings, as many state regulators do, it in effect conducts merit review on the investors themselves, deeming only some sufficiently capable of making their own choices about how to invest and what risks to assume.

Additionally, although the restrictions on investment in private offerings are often attributed to their inherent riskiness, the numbers tell a different story. Cambridge Investments provides an index of available private investment performance data and constructs benchmarks of public indices that allow for a comparison of the internal rate of return (IRR). As Figure 58.4 shows, the IRR for private equity has largely tracked, or in many years outperformed, returns for the S&P 500.

The current rules have established private securities as an attractive investment that is, however, directly available only to an exclusive set of wealthy investors. Congress should define private offerings as any offering not listed on an exchange. And it should open all offerings to all investors. Congress could require that anyone offering securities in a private offering disclose to potential investors that the offering is private and that it therefore lacks the protections afforded by public offerings. Investors would then be able to choose for themselves whether to invest only in public offerings—if they prefer the protections in the 1933 and 1934 acts—or in more loosely regulated private offerings as well.

Figure 58.4
Private Equity vs. S&P 500 Internal Rate of Return, 1986–2014



SOURCE: Cambridge Associates, "U.S. Private Equity Index and Selected Benchmark Statistics," PowerPoint presentation, December 2015.

If such a change in the securities laws is not politically feasible, then the category for accredited investors should at least be expanded to more accurately capture investors most likely to be able to "fend for themselves." For example, those who have passed the Financial Industry Regulatory Authority's (FINRA) basic stockbroker's exam, the Series 7, and those who have passed the exam for financial advisers, the Series 65, should be deemed financially sophisticated and be counted as accredited investors. As the law currently stands, investment advisers may advise clients to invest in securities they themselves may not buy because they are deemed insufficiently sophisticated. The category could also be expanded to allow those with expertise in a particular field to invest in offerings related to that industry. Expertise could be defined as either a university-level degree in the field or a certain number of years of experience working in the industry.

Given the size of the private equity markets and the extent to which they currently dwarf the public markets, the bar that keeps the vast majority of the population from sharing in this engine of wealth is at odds with a democratic society. More opportunities for investment would result in more opportunities to build wealth as well as more opportunities for businesses to access needed capital to grow, adding jobs and building our economy.

Bringing Friends and Family Out of the Shadows

Although past guidance recommended a consideration of all facts surrounding an offering to determine whether it constitutes a "public" offering,

this understanding has largely faded. Regulation D and its predecessors, Rule 146 and Rule 242, as well as the *Ralston Purina* case helped cement the notion that whether an offering is public or private turns principally on whether the investors are rich or not. The absurd result is that even a tiny offering to a tiny group of investors who are close personal friends and relatives of the issuer's executives may still be deemed a "public" offering requiring registration. These tiny offerings—in which an aspiring restaurateur or a couple of friends building an app in someone's garage ask their parents, cousins, and good friends to "go in on" the enterprise with the hope of getting "a cut of the profits" down the road—still happen. And they happen without registration, often without the issuer ever understanding that the transaction being proposed is in fact a sale of securities (typically something akin to common stock) to unaccredited investors.

It is arguably within the SEC's authority to deem such offerings exempt, either as nonpublic offerings or through its authority to exempt "any class of securities . . . if it finds that the enforcement of [the registration requirements of the Securities Act] with respect to such securities is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering." The SEC has not, however, used this authority to provide such an exemption. Instead, it continues to consider these offerings to be in violation of the securities laws. Although the SEC rarely pursues enforcement actions against such offerings, it has been known to pick up the phone and issue a stern warning to violators.

It is not clear, however, why the SEC should be involved with extremely small offerings, especially if those offerings are made exclusively to friends and family. These tend to be matters based as much in social and familial relations as financial. Because few issuers are even aware their actions are governed by securities laws (or indeed that they are even acting as "issuers"), the current proscriptions do little to prevent such extra-legal offerings. Instead, they only complicate the process when an issuer grows and moves on to more formal methods of raising capital. Then the issuer must engage a lawyer to unwind its investors' positions, providing rescission offers to all early investors.

A better solution would be for Congress to enact an explicit de minimis exemption. The exemption could include a cap, for example $500,000, on the amount raised. If it was deemed necessary, there could also be a requirement that investors have a preexisting relationship with at least one senior executive within the company. This type of exemption would free

the offerings that already happen, and will continue to happen, of legal encumbrance, allowing entrepreneurs to focus on building the business and ensuring their friends' and family's investments are sound ones.

Conclusion

Capital markets direct the flow of resources to enterprises. Ideally, these resources flow freely, attracted to the companies that will put them to best use based on the needs and wants of the end consumers. Regulation functions like rocks in a stream, redirecting the flow. Too much regulation, and regulation implemented without regard to its effects, risks choking the flow of capital entirely, or artificially flooding one area of the economy while leaving another dry. The trend toward ever more regulation in the financial sector has left in place regulation that provides little good while imposing great cost. Continued economic growth and progress toward healthier, more comfortable lives depend on ripping out those regulations that neither deter fraud nor improve price and only serve to stymie growth and innovation.

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—Prepared by Thaya Brook Knight

59. Technology Freedom

Policymakers should

- resist the temptation to specially regulate new technologies and technology-related business models;
- foster market regulation and apply common law principles to real problems as they arise; and
- maintain the free-speech protections of the Communications Decency Act's section 230.

Society gets the most from technology and technology-related businesses when legislators and regulators give technologists and businesspeople the maximum freedom to experiment and innovate. When problems arise, government regulation is often poorly suited to addressing them. The best solutions are most often found in market responses and common law rules. This has been true with past technology developments and is true with respect to new technologies such as virtual reality and drones; sharing-economy businesses such as Uber and Airbnb; new technologies such as Bitcoin; and continually developing issues such as privacy, Internet governance, and "net neutrality." The regulations that *are* needed in the information technology area are those that control governmental and legal incursions on free speech. Congress should maintain the protections of section 230 of the Communications Decency Act of 1996.

A Selective History of Technology Regulation

Decades into the Internet era, experience shows that it is unwise to regulate technologies and businesses in anticipation of problems. Sometimes expected problems don't materialize. When they do, additional technology development is often the solution, and prescriptive regulation may do little to address the real problems. Policymakers should address new

technologies with the circumspection that experience teaches by leaving technology alone until there are clear problems that can only be solved through law or regulation.

A cautionary tale about the impulse to regulate new technologies can be found in the excitement during the 2000s about radio frequency identification (RFID) technology. In its time, RFID was going to be a multibillion dollar industry, and RFID tags were going to be found in and on nearly everything, from shirts to water bottles. The anticipated result was the potential for intensive tracking of people through their things and a wide variety of risks and harms attendant to that tracking. But RFID technology did not take off to the extent predicted. There are certainly many uses for RFID, but if regulators had comprehensively addressed RFID in light of its anticipated omnipresence, they would have wasted their own time on problems that ultimately didn't materialize.

The lessons of the RFID vogue are clear for today's highly anticipated "Internet of Things." It may be that a massive number of new devices, from refrigerators to thermostats, get connected up to the Internet. But the future of the Internet of Things may not be so great. There will be time, if new issues arise, to address them as they occur. Regulating on the basis of what is anticipated is more likely than not to miss the mark.

Challenges produced by technology are often best addressed by additional technology development. Spam email, for example, was a scourge of the Internet for a time. In 2003, Congress passed the CAN-SPAM Act, which went far beyond targeting large-scale spammers and included a variety of broad regulations that still impose compliance costs on legitimate businesses. But it did little to stop spam. Technical and business solutions, such as spam filtering by email service providers, have curtailed spam. At the same time, the opening of additional communications channels and platforms has reduced the importance of email, and spam along with it. CAN-SPAM and all the state email regulations it preempted are irrelevant and should be repealed.

Spyware was a similar scourge of a past decade. The word "spyware" stood for a small universe of programs that might be delivered to people's computers while they were browsing the World Wide Web. Once installed, these programs might report back on the browsing or other computer activity of the user. There was little legislation could do about spyware, in part because the spyware could originate anywhere in the world. Improvements in browser and computer security—not legislation—contained the spyware problem.

The Children's Online Privacy Protection Act is an example of a federal law passed in anticipation of problems that may or may not have materialized, but that probably thwarted beneficial developments. To protect children from online advertising, the act placed onerous parental permission requirements on websites that aimed themselves at young audiences. As a result, a market for websites that would serve educational, age-appropriate content to children never really emerged. Passage of this legislation deprived our society of tools that kids in impoverished circumstances could use to learn and advance themselves. It's a cost of regulation that is hard to measure because positive developments that don't happen don't announce themselves to the world.

The history of technology regulation and development shows that technology trends are hard to predict and thus to anticipate in regulation. It is often technology and business developments that will cure or contain technology-based problems. And prescriptive regulations can cut off developments that would be good for consumers and society.

Privacy, Security, and Net Neutrality: The Need for Restraint in Regulation

Unlike spam and spyware, privacy and security issues are still being hammered out as society encounters new technologies and new information-based business ideas. Companies are discovering new uses for data that better inform and serve consumers. Sometimes those uses are concerning. But as history again shows, experimentation is superior to regulation at divining consumers' true interests. Regulation in this area is nearly impossible to craft well, and it is most likely to foreclose innovations that would serve our society and the economy very well. The federal "net neutrality" regulation, among others, is a case in point.

In 2000, the Federal Trade Commission issued a list of "fair information practices" (notice, choice, access, and security) that it thought online companies should adhere to. The commission asked Congress for authority to impose them in regulation. Had the agency succeeded, Google might have had a far more difficult time producing and sustaining its massively enriching search engine, as well as the many ancillary products it provides, such as its invaluable mapping tools.

In 2006, Facebook introduced a new feature called the "News Feed," which aggregated the activities of each user's friends on his or her wall. This was met with a privacy firestorm, because people were unused to the idea of others getting immediate updates about the things they posted.

The information in Facebook's News Feed was not newly revealed, just aggregated in a new way. Public reaction prompted Facebook to create better user controls for posted content. Today, the News Feed is the heart of the Facebook experience for most people. Had regulation foreclosed this option, people would not have the kind of access to each other through social media that they have today—a level of access that most people now appreciate. As surely as Facebook changed privacy norms, it was changed by privacy norms. And just as surely, other companies will produce other products that enhance our lives and sometimes cross privacy lines. This trial-and-error process is the way our society advances, and it should not be foreclosed by regulation.

Security is a similar area, long the subject of keen lawmaker and regulator interest. Aside from a few sectoral laws, such as in financial services, there has not been comprehensive security law or regulation. This is because the subject area is too complicated to capture. Instead, owners of business processes and holders of personal data are responsible for ensuring that they do not breach sensitive information that can be used to their detriment or to harm or mortify the subjects of private data.

Net neutrality is an area of long dispute in which the Federal Communications Commission has made undesirable regulatory inroads. After years of struggle, the commission finally issued a regulation in 2015 that could survive court challenge. The agency's "Open Internet Order" purports to protect against wrongful behavior on the part of Internet service providers (ISPs), but offenses against the open tradition of the Internet have been rare, and they should not be against the law. Regulating ISPs prevents them from experimenting with technologies and business processes that may deliver better Internet service to more customers.

ISPs should be just as free to innovate and compete as any other technology-related business. The structure of the ISP market tends toward centralization, but that problem is better resolved by inviting new competition, such as by allowing novel uses of electromagnetic spectrum that could deliver wireless high-speed Internet access to consumers.

The Latest Wave of Innovations

Experience demonstrates that restraint is the best approach for lawmakers and regulators addressing themselves to technology and the Internet. This is just as true for the latest wave of innovative technologies and business models.

The prevalence of handheld devices with location awareness and downloadable applications has fostered the creation of a number of exciting new "sharing economy" businesses, such as Uber, Lyft, Airbnb, TaskRabbit, and Thumbtack. These companies act as connectors between independent service providers and consumers. They bring otherwise underutilized assets like cars and apartments into use and allow individuals to run small businesses that earn extra income. Their reputation systems create incentives for excellent service that easily surpass the consumer protections offered by existing regulators, such as taxicab commissions.

Being superior to preexisting services in almost every dimension does not mean businesses in the sharing economy are without controversy. The taxi industry has tried to portray car-sharing as unsafe, though it is not. The hotel industry and hotel workers' unions have sought to undercut apartment-sharing and to ensure that travelers staying in shared housing pay taxes as heavy as those staying in hotels. Rather than saddling new business models with old-school regulations, the regulations that prevent the existing taxi or hotel industry from providing excellent, cost-efficient service should be cleared away.

A variety of new technologies should get the same hands-off treatment that experience favors. Privately owned, unmanned aerial vehicles (drones) have many exciting uses, and more are invented all the time. Concerns about their safe operation and the privacy consequences of drone photography can be addressed without creating heavy-handed and deadening regulation that puts dampers on the benefits of distributed aerial experimentation. Virtual reality is another field that may burgeon if regulators do not capitalize on anecdotal negative experiences.

Fascinating technologies like Bitcoin also should be spared the full regulatory treatment that weighs down the existing financial services industry (as New York tried to do with its notoriously ill-thought-out "BitLicense"). Rather, the cryptocurrency market should be allowed to develop so that people around the world can get access to financial services like those enjoyed in America and Europe. Bitcoin's technology combined with new business models and practices can foreclose risks that are inherent in traditional banking. Real-time, cryptographically proven statements of assets, for example, mean that Bitcoin businesses do not have to be as opaque to their customers as banks naturally are.

The technology sector is working to deliver many more improvements. Driverless cars offer not only the huge benefit of safer transportation for millions of people, but they will have environmental benefits and permit

cities to reduce parking congestion. Anecdotes about incidents should not combine with fear of the unknown to slow the adoption of driverless car technology, which can be vastly and provably more safe than human-operated vehicles.

Having regulators examine each technology with an eye toward "consumer protection" and a properly formed-up marketplace is not the best system. The superior option is to make use of common law, basic rules that apply to everyone in the United States whether they work in technology or not.

Common law is a legal inheritance from England in which the rules that govern our interactions have arisen from years of experience over generations: avoid violence and injury to others, stick to promises, and allocate things in an orderly way. The law of battery, tort law, contract law, and property law all emerged as common practice solidified into common law. Common law requires drone operators and authors of driverless-car software to ensure that they do not injure others. It requires Bitcoin companies to provide promised services to their customers. And it permits people to interact commercially any way they like, so long as they don't violate the rights of others. Common law supplies consumer protection without the cost and intrusion of bureaucratic regulation.

Protect Internet Speech

Had it been given time to work its will, common law would almost certainly have found that individuals who post material on websites and services are responsible for their own speech and that operators of websites are not responsible for the speech of others. This rule is one of the most important after the First Amendment for protecting the vibrant marketplace of ideas that can be found on the Internet.

It was made law in the Communications Decency Act, federal legislation that Congress passed in 1996. Controversial anti-indecency provisions in the law were struck down as unconstitutional, but section 230 of the act remained. It holds that interactive computer services are not publishers or speakers of any information that others provide when using the services. That means a website or service is not legally responsible for the material that others post if, for example, that material is libelous.

Without section 230, operators of online services would probably have allowed only tightly controlled and monitored interactions among users. The rollicking, interactive Internet we know today would have been sharply curtailed.

Section 230 has come under attack from groups who would like to see it reversed. They want websites and similar services to be treated as responsible for content they host—placed there by others—and thus to control the speech of users. But that would be hugely expensive to administer and would undercut many websites and Internet services.

The protection of the Communications Decency Act keeps lawsuits from taking down highly valuable, interactive online services. The general policy of allowing technology and technology-related business to develop in freedom is the surest way to get the many, many material and social benefits of technology for all the world's people.

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—Prepared by Jim Harper

60. Health and Safety Policy

Congress should

- limit health and safety regulations to cases where clear market failures exist; and
- mandate that all health and safety regulations must pass cost–benefit analysis, and do so by a considerable margin.

Before the 1970s, federal health and safety regulations did not exist, with the exception of certain regulations for food safety and prescription drugs. Ralph Nader's 1965 book *Unsafe at Any Speed*, about motor vehicle safety, started the modern politicized safety and health movement and led to the establishment of the National Highway Traffic Safety Administration in 1966. The Occupational Safety and Health Administration followed in 1970, the Consumer Product Safety Commission in 1972, the Nuclear Regulatory Commission in 1974, and the Toxic Substances Control Act in 1976.

Should the Government Regulate Risk?

People make many private decisions about their health and safety. Why should government become involved in those decisions? Proponents of government regulation argue that people sometimes make bad decisions, as a result of insufficient knowledge about the harms they face, or because their decisionmaking ability, itself, is flawed. Are those proponents correct?

When Risks Are Known

In many markets, safety risks are well-known. Using detailed data on wages and fatality risks across occupations, economists have estimated people's tradeoffs between money and fatality risk, thus establishing the "value of a statistical life"—that is, how much money people are willing to spend to reduce their statistical risk of death. Interestingly, though

there are many different ways to calculate this value, and though individuals can vary dramatically in their risk preferences, across-population estimates fall into a surprisingly small range. For instance, workers, on average, demand a risk premium of about $910 to face an additional annual work-related fatality risk of 1 chance in 10,000 ($9.1 million per statistical life).

That demand shows that market forces create safety incentives—employers must either pay the premium or pay for safety precautions that reduce the risk. We are not operating in a world in which there are no constraints other than regulatory intervention to promote safety. Because workers and employers are already using market forces to resolve their differences on the taking of known risks, government should not use regulations to override those resolutions.

When Risks Are Unknown

But what of unknown risks? Say a new drug has been invented. Won't consumers demand that a government agency determine that the drug is safe before it is put on the market?

Some people are risk averse and others are not. Some people would refrain from using the drug until it has undergone clinical trials with random assignment of subjects, while others would simply accept recommendations from friends and relatives. And the risk averse may have questions and concerns that will take an extensive period of clinical research to address (and may never be addressed to their satisfaction). If someone uses the product daily for 40 years, would life quality or expectancy be reduced or enhanced?

The beauty of markets is that they can accommodate all these possibilities simultaneously for private goods. One firm can offer something for sale with "evidence" while other firms can offer things for sale without "evidence." Underwriters Laboratories and Kosher certification are examples of the private provision of quality "evidence." Such a state of affairs is called a "separating equilibrium": differing degrees of quality and safety are provided at different prices, and consumers choose the package of price and quality that they prefer.

A market that does not separate is said to "pool." In a pooled market, price and quality variation are not sustainable: either consumers are unwilling to pay for the costs of quality differences, or market characteristics prevent firms from credibly committing to quality. In that last category, consumers have difficulty differentiating good- from poor-quality prod-

ucts. Only then is it possible for government intervention to improve human welfare.

Pooling and Safety Regulation

An example of a pooled market is one that consists of numerous small-scale, anonymous producers whose output is combined without branding. In such a market, consumers can't identify—and reward—producers that supply good products. Traditionally, many agricultural products have been sold this way.

When a safety scandal occurs in an anonymous pooled market, the government responds with "regulation" and "inspection." Consumers are reassured. But the inspection budgets and systems are inadequate to prevent future safety and health events. New safety incidents occur and the cycle repeats.

In the past 10 years, Congress has responded to two health and safety episodes in this fashion. Lead paint was discovered on children's toys imported from China, and a salmonella outbreak was linked to peppers imported from Mexico. Those developments induced Congress in 2008 to pass new consumer product safety legislation and President George W. Bush to increase the appropriation request for the Food and Drug Administration (FDA) for fiscal year 2009 by $275 million.

Such responses reinforce the mistaken belief that markets are incapable of credibly providing adequately safe products. The toy market isn't just anonymous producers from China. U.S. manufacturers emphasize quality and safety in return for a higher price. But consumers deserted such products, often sold in small independent stores, and bought imports from China sold for less at large chain stores.

When the lead paint came to light, toy suppliers didn't respond by shifting to U.S.-made toys. Rather, the large importers requested that the Consumer Product Safety Commission increase its regulation of the industry. The importers wanted to use regulation to force the market to pool again—to convince the consumer not to think about price and quality tradeoffs because of government assurances of quality. That is a clear form of corporate welfare.

The use of regulation by some firms to provide quality assurance exacerbates the tendency of consumers to think that everything for sale should be approved by the government. That tendency, in turn, increases the probability that low- and high-quality products will "pool" rather than "separate," which undermines the market provision of safety.

Separation and Market Provision of Safety

The decisions of three firms illustrate how markets can provide safety and health benefits when they separate rather than pool:

- In 2012, Johnson & Johnson announced the elimination of three ingredients in their products in response to consumer concerns: (1) phthalates; (2) preservatives that result in the formation of formaldehyde; and (3) triclosan, an antibacterial agent used in soaps. Each of those ingredients had come under public scrutiny because of safety concerns.
- In 2013, Whole Foods became the first retailer in the United States to require labeling of all genetically modified foods sold in its stores because of consumer demand. Some of their vendors have seen a 15 percent increase in sales since they labeled their products as not having such ingredients. It should be noted that no scientific basis exists for concerns about genetically modified foods, but markets respond to preferences regardless of their scientific validity.
- Animal welfare advocates and those concerned about the development of antibiotic-resistant bacteria have long condemned the widespread use of antibiotics in the raising of food animals to increase their growth rates and prevent disease. They also have called for regulation to implement their views, but the FDA issued only voluntary guidelines in 2012. In 2015, poultry processor Perdue Farms announced an ad campaign to promote its "antibiotic-free" chicken. In 2016, Perdue announced new animal welfare standards, including more light and space for the animals and the use of anesthesia before slaughter.

When consumers care about, are informed (and even misinformed) about, and are willing to pay for health and safety, firms have incentive to provide it.

The Development and Provision of Knowledge

Current federal policy treats the development of knowledge about health and safety effects inconsistently across products. Pharmaceuticals must undergo clinical trials before the FDA will even consider allowing them to be sold. But surgery is completely unregulated. And food supplements are sold with a label that states, "This statement has not been evaluated by the Food and Drug Administration. This product is not intended to diagnose, treat, cure, or prevent any disease."

Given the earlier discussion of market demand for safety, one might expect that unregulated products like supplements engage in rigorous private development and certification of knowledge and efficacy. Unfortunately, they do not. Thus, they are susceptible to the "scandal–regulate–rinse–repeat" cycle described earlier.

Even the existence of regulation does not necessarily result in the development of knowledge necessary for consumers to make informed decisions about safety and health. For instance, the Toxic Substances Control Act of 1976 gave the Environmental Protection Agency (EPA) limited powers to regulate "existing" chemicals—those substances that were in commerce at the time of enactment (roughly 60,000 in number). The EPA could regulate an existing chemical if it first determined that it posed an unreasonable risk. But to make that determination, the agency had to gather significant amounts of data, which were simply unavailable. Producers, of course, now had *dis*incentive to gather that information because it could lead to their products being prohibited. Without any information, the EPA could not regulate. This stalemate lasted for 40 years. Markets cannot possibly operate to reduce risk under such circumstances: the information that would aid decisionmaking is actively suppressed by the disincentives created by the law.

Other players—including other countries, U.S. states, major retailers and consumer product companies, and trial lawyers—filled the gap created by the federal stalemate. But chemical companies did not want an "arms race" to develop among those actors in which the companies might have to respond to strong anti-chemical preferences. Congress finally reacted in 2016 by granting the EPA increased powers (and fewer hurdles) to gather knowledge about existing chemicals in return for greater preemption of potentially more-hostile state action. Once the EPA makes a final decision about one of the existing chemicals, states lose their regulatory authority over that chemical.

Preemption of state regulation is also the driving force behind congressional action on the labeling of foods with genetically modified ingredients. Like the stalemate with the Toxic Substances Control Act, the lack of federal action on this issue over the years has led to political pressure at the state level. A Vermont law requiring the labeling of foods with genetically modified ingredients went into effect on July 1, 2016. But national food processors want uniform national labeling and preemption of state action. So, even though the National Academies of Sciences, Engineering, and Medicine reported finding no scientific basis for linking genetically modi-

fied crops to any adverse health effects, Congress enacted legislation to preempt the Vermont effort.

Federal policy toward genetically modified organisms is contradictory. Compare the Vermont labeling case to that of salmon. The scientific consensus is that no health or environmental consequences exist as a result of the genetic modification of salmon, which allows the fish to grow to market weight faster. In 2015, the FDA approved the sale of genetically modified salmon and concluded that the fish would not have to be labeled as such because of the scientific consensus.

Assessing Regulatory Performance

Table 60.1 lists various health and safety regulations and their estimated opportunity cost per life saved (in 2002 dollars). Because the legislative man-

Table 60.1
Opportunity Costs per Statistical Life Saved
(Millions of 2002 Dollars)

Regulation	Year Issued	Agency	Opportunity Cost per Statistical Life Saved
Childproof lighters	1993	CPSC	$0.1
Unvented space heaters	1980	CPSC	0.2
Trihalomethane	1979	EPA	0.3
Food-labeling regulations	1993	FDA	0.4
Children's sleepwear flammability	1973	CPSC	2.2
Child restraints	1999	NHTSA	3.3
Grain dust	1988	OSHA	11.0
Benzene	1987	OSHA	22.0
Coke ovens	1976	OSHA	51.0
Asbestos ban	1989	EPA	78.0
DES (cattle feed)	1979	FDA	170.0
Sewage sludge disposal	1993	EPA	530.0
Land disposal restrictions: Phase II	1994	EPA	2,600.0
Drinking water: Phase II	1992	EPA	19,000.0
Formaldehyde	1987	OSHA	78,000.0
Solid waste disposal facility criteria	1991	EPA	100,000.0

NOTE: CPSC = Consumer Product Safety Commission; DES = diethylstilbestrol; EPA = Environmental Protection Agency; FDA = Food and Drug Administration; NHTSA = National Highway Traffic Safety Administration; OSHA = Occupational Safety and Health Administration.
SOURCE: W. Kip Viscusi, "Regulation of Health, Safety, and Environmental Risks," National Bureau of Economic Research Working Paper no. 11934, January 2006.

dates vary, there is also great variance in the cost per life saved. Indeed, the cost varies even within certain regulatory agencies. For example, the EPA's regulation of trihalomethane in drinking water has an estimated cost per statistical life saved of only $300,000, while the regulation of sewerage sludge disposal has an estimated cost per life saved of $530 billion. A regulatory system based on sound economic principles would not spend more than the risk premium found in private markets to value a statistical life (approximately $9.1 million) and it also would reallocate resources from the high- to the low-cost regulations. That would result in more lives saved at the same cost to society (or equivalently, shifting resources could result in the same number of lives saved at a lower cost to society).

Effect of Regulation on Accident Rates

What has been the overall effect of the emergence of health and safety regulations since the early 1970s? One yardstick of performance is whether accident rates have declined. Figure 60.1 summarizes fatality rates from accidents. The basic message of Figure 60.1 is that accident rates have declined throughout the past 85 years (that trend has recently stopped because of an increase in falls due to an aging population and drug overdoses included in "poisonings"). The improvement in our safety is not a new phenomenon that began with the advent of regulatory agencies commissioned to protect the citizenry.

Figure 60.1
Unintentional Injury Deaths in the United States, 1928–2013: All Accidents

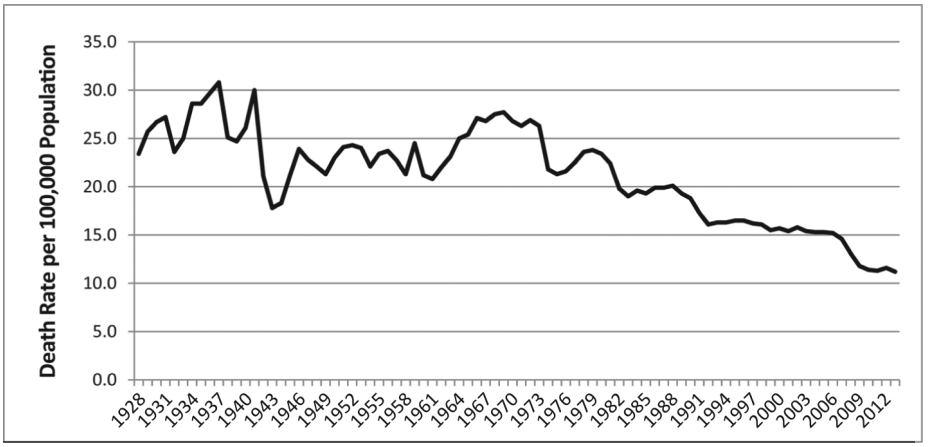
SOURCE: *Injury Facts* (Itasca, IL: National Safety Council, 2015), pp. 46–47.

Figure 60.2
Unintentional Injury Deaths in the United States, 1928–2013: Work

SOURCE: *Injury Facts* (Itasca, IL: National Safety Council, 2015), pp. 46–47.

For example, Figure 60.2 shows no significant downward shift in the trend for job fatality risk after the establishment of OSHA in 1971. (The break at 1992 is the result of changes in the Bureau of Labor Statistics' census of fatal occupational injuries for work-related deaths.) And Figure

Figure 60.3
Unintentional Injury Deaths in the United States, 1928–2013: Motor Vehicles



SOURCE: *Injury Facts* (Itasca, IL: National Safety Council, 2015), pp. 46–47.

60.3 shows that auto fatalities declined steadily throughout the last 85 years as well. As in the case of the other accident statistics, there is no evidence of a sharp, discontinuous break in the downward trend that occurred with the advent of regulatory policies.

The steady decrease in risk over time supports the hypothesis that market forces rather than regulatory policy have likely been the most important contributor to safety improvements.

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—Prepared by Peter Van Doren

61. The Minimum Wage

Congress should

- repeal the federal minimum wage; and
- using its authority under the Commerce Clause, prohibit state and local governments from establishing minimum wages.

State and local lawmakers should

- repeal state and local minimum wage laws.

The "Fight for $15" movement is mustering supporters and critics of minimum wage laws to their traditional battle stations. Supporters argue that raising the minimum wage would help the working poor at a time of high living costs and growing income inequality. Opponents respond that it would harm critical entry-level employment at a time of high, persistent joblessness for low-skilled and new workers. Both sides spout economic theories and cite empirical studies to back their positions and discredit the other side.

The preponderance of the scholarly literature is on the critics' side. But employment effects alone do not discredit minimum wage supporters' position; they can still argue that a higher minimum wage would improve public welfare even if it raises unemployment. This chapter argues the exact opposite: for both economic and public welfare reasons, minimum wage laws should be *repealed*. For their mutual benefit, laborers and employers should be free to strike work agreements at any wage rate.

Economic Theory

Supporters and critics of minimum wage laws both cite classical price theory—the interaction of supply and demand—to support their positions. They differ, however, on important assumptions about the real-world

conditions of labor supply and demand: specifically, the number of people who want jobs and how badly they want them, and the number of jobs that are available to them and how badly employers want to hire them.

Classical price theory usually assumes there are many potential suppliers and consumers for a good such as labor. These would-be consumers and suppliers decide whether to buy and sell the good based on the price they would pay or receive for it; if the price is too high, consumers will buy less, and if it is too low, producers will provide less. These decisions result in an equilibrium price and quantity of goods exchanged in the market.

Minimum wage law supporters typically believe there is relatively little demand for low-skill, inexperienced labor, but there is ample supply. As a result, employers of such workers have "market power" and will pay wages well below the equilibrium price. As a result, low-skilled workers must accept (or decline) wages that are insufficient to support a family—a situation the supporters argue is harmful to public welfare.

Critics of minimum wage laws respond that, yes, there are more low-skilled workers than there currently are jobs for them. But that's because minimum wage laws prohibit employers from paying many low-skilled workers the value of their labor. Some jobs simply aren't profitable enough, and some labor isn't valuable enough, to justify paying those workers the minimum wage plus other costs that employers must bear for workers (e.g., payroll taxes, training costs, health care and other benefits, liability insurance). As a result, potential low-skilled workers endure unemployment and struggle to accrue the skills and experience that would lead to better pay. If those workers are willing to accept such jobs, even at low pay, then minimum wage laws that prohibit such arrangements hurt those workers and public welfare.

Empirical Evidence

Both theories are prima facie plausible. They are also empirically testable to determine which better describes the U.S. labor market. If minimum wage supporters are correct, increasing the wage would increase employment as the higher wage would induce more low-skilled individuals to join the workforce; if critics are correct, raising the minimum wage would result in *less* employment.

Supporters frequently cite a 1994 paper by economists David Card and Alan Krueger as evidence that their characterization of the low-skill labor market is correct. Card and Krueger found that a 1992 New Jersey minimum wage increase resulted in higher fast-food restaurant employment

in that state's part of the Philadelphia metropolitan area relative to the Pennsylvania part. But that is just one of several dozen empirical studies of the employment effects of minimum wage increases. Is the Card and Krueger paper representative of that broader literature or an outlier to it?

In 1977, the U.S. Congress and President Jimmy Carter formed the Minimum Wage Study Commission to identify the effects of these laws and make recommendations for future policymaking. The committee's senior staff economists, Charles Brown, Curtis Gilroy, and Andrew Kohen, assembled a literature review of prominent empirical studies of minimum wage laws; the review was later published as an academic article. After examining more than 30 studies, Brown, Gilroy, and Kohen determined the following:

- For teenagers, who comprise a large share of minimum wage workers, studies typically found that a mere 10 percent increase in the minimum wage resulted in a 1–3 percent decrease in employment. The authors add that "the lower half of that range is to be preferred."
- For young adults age 20–24, who comprise another large share of minimum wage workers, studies found the employment effect "is negative and smaller than that for teenagers."
- For adults over age 24, who are a minority of minimum-wage workers, the employment effect "is uncertain."

The commission's report apparently soured Washington's enthusiasm for the minimum wage, as Congress did not seriously consider another increase until a decade later. However, several states and local governments enacted or bolstered their own minimum wage laws during that interval. Those policy changes allowed economists to use cross-state analysis to estimate the employment effects of such increases. A wave of new research appeared in the academic literature, including Card and Krueger's.

In 2006, economists David Neumark and William Wascher produced an exhaustive review of the new research. They found that "nearly two-thirds [of the 102 analyses they reviewed] give a relatively consistent (although by no means always statistically significant) indication of negative employment effects of minimum wages while only eight give a relatively consistent indication of positive employment effects." Further, of the 33 analyses that Neumark and Wascher "view as providing the most credible evidence[,] 28 (85 percent) . . . point to negative employment effects. Moreover, when researchers focus on the least-skilled groups most likely to be adversely affected by minimum wages, the evidence for disemployment

effects seems especially strong." They conclude, "We view the literature—when read broadly and critically—as largely solidifying the conventional view that minimum wages reduce employment among low-skilled workers."

A few more empirical studies have appeared since Neumark and Wascher's. The most important of these is by economists Jonathan Meer and Jeremy West. Innovatively, instead of following the traditional research method of comparing employment *levels* (i.e., the number of people employed) before and after a minimum wage increase, they looked at changes in employment *rates*: If employment was trending upward or downward before the wage increase, did that trend slow down or speed up? Meer and West's approach helps to isolate the effect of the minimum wage change from other factors that might be affecting the economy. They find much larger harmful effects from minimum wage increases than what earlier studies had generally indicated, and those effects were especially strong in retail and construction—job sectors that are especially important to low-skilled and new workers.

Overall, the empirical literature strongly supports minimum wage law critics: these laws hurt employment, especially for low-skilled, young, and minority male workers.

Beyond Employment Effects

Given the empirical evidence, some minimum wage supporters concede that, yes, these laws do hurt employment. But, they say, the lost jobs are a worthwhile tradeoff for boosting wages for other low-skilled workers who find employment, thereby reducing poverty.

The problem is, minimum wage increases historically have proven to be poor tools for fighting poverty. People working at or near the minimum wage typically aren't primary earners, but are secondary or tertiary earners in middle- to upper-middle-class households. In contrast, impoverished households usually aren't struggling with low-wage jobs, but with having no jobs at all.

Given that, it's unclear whether would-be low-wage workers benefit from minimum wage increases. Some receive more money, but others lose work hours or desirable employment opportunities. The teenagers who want an after-school job to help them buy their first car and establish a work history, the students who want paying internships, the first-time workers who are willing to "pay their dues" to pursue higher ambitions, young workers with low living costs, idealists who will accept a low wage

to work for a cause, people who want to make a little money while helping an entrepreneurial friend, seniors who want a little extra income—all of them would be hurt by a higher minimum wage. And so would their employers and customers: the summer camp that will hire fewer counselors and lifeguards, the nonprofit that can't afford higher stipends for its interns, the local diner, the business that hires applicants with thin work histories, the employer whose jobs don't pay much but are pleasant to do. All of those losses reduce public welfare.

Conclusion

The U.S. economy provides a wide variety of jobs at many different wage rates. To get better-paying jobs, workers need entry-level opportunities that build skills and work histories. And if a job proves too demanding for the wage offered, a worker is free not to accept it or to quit. Politicians shouldn't interfere in those workers and employers' private agreements. For those reasons, the minimum wage shouldn't be raised—it should be abolished.

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—Prepared by Thomas A. Firey

62. Labor and Employment Law

Congress should

- repeal the National Labor Relations Act;
- repeal the federal minimum wage, overtime, and other provisions of the Fair Labor Standards Act;
- repeal the Family and Medical Leave Act;
- repeal the Davis-Bacon Act ("prevailing wages");
- require the Department of Labor to follow notice-and-comment rulemaking and to conduct economic analysis before issuing regulations that increase burdens on private parties;
- repeal federal age discrimination law, including its ban on the practice of automatic retirement ages at private workplaces;
- repeal in whole or large part the Americans with Disabilities Act, in particular, its coverage of disabilities beyond traditional categories such as deafness, blindness, and paraplegia; and
- reverse executive orders on employment practices of federal contractors that do not either safeguard constitutional principles or assist the government in procuring the best-quality and lowest-cost products and services from a wide universe of contractors.

"Employment at will" is the phrase that developed to describe the law governing labor markets in a free society: either party could bring an employment relationship to an end, typically on short notice, and terms of pay and benefits were left for the two sides to negotiate. The federal labor law ushered in by the Progressive Era and New Deal infringed on

that liberty in several ways. For example, it became unlawful for an employer not to bargain with a union that claimed the support of a majority among a group of workers; minimum wage and overtime rules applied regardless of the two sides' preference for other terms; and so forth.

Although labor unions were an institution central to the New Deal scheme, they entered a long decline after World War II. Union membership fell from a peak of 35 percent of wage and salary workers in 1945 to 11 percent in 2014, and only 6.6 percent in the private sector in that year. That decline is in stark contrast to the health of public-employee unions, which now boast 35.7 percent density. The strike threat also declined, from a peak of 60 million workdays lost annually in the late 1950s to approximately 1 million now. The political power of unions, however, has remained important, with the decline of some once-mighty industrial and trade unions offset by impressive gains for their counterparts in government employment.

All the while, private employers' legal worries remained. Even as union bargaining shrank in importance, new kinds of legislation and litigation grew. Where unions had once angled for "fringe benefits," for example, Congress and other levels of government now enacted laws mandating benefits that had previously been voluntary: family leave, medical coverage, pregnancy benefits, and so forth. Already favored by the tax system, and now also the subject of legislative prescription, employee benefits became a large part of compensation packages; their cost to employers sometimes rivaled that of wages or salaries themselves.

Government was also interfering more with decisions to hire and, especially, fire. The most important single contributor was the steady expansion of anti-discrimination law from the 1960s onward. First came the seemingly limited goal of overcoming the legacy of racial discrimination. Then, before long, the list of protected categories included sex, age, disability, veteran status, and many others. Most employees fell into at least one protected category; that meant, if fired, they might cast back over their experience to identify some evidence of bias and sue, arguing that bias played a role or that they had suffered related injuries such as retaliation or harassment. Age and disability were especially important expansions because age had traditionally been a "legitimate" reason for termination—but now standard policies requiring retirement at age 65 became unlawful. In some cases, workers fired for inability to carry out job responsibilities could sue by alleging that the employer had discriminated against them on the basis of illness, disability, use of leave, mental/emo-

tional issues covered by the Americans with Disabilities Act (ADA), and so forth.

Four Great Moments in European Labor Law

Economists often credit America's successful culture of entrepreneurial startups, especially in creative and technology fields, to our relatively free labor market. In places like Europe, governments have gone much further to regulate hiring and firing of workers, conditions on the job, and even pay scales. Four examples from the headlines follow:

- "German army forced to lay down weapons due to 'overtime limits.'" *The Telegraph* (UK), April 10, 2016.
- Immediate client service turnaround? Mais non! "France might pass a law that makes it illegal to send after-hours work emails." *Washington Post*, May 12, 2016.
- European Union regulators have ordered symphony orchestras to reduce the decibel level of many standard works in the concert repertoire, lest musicians suffer hearing loss. "Music; the Shushing of the Symphony." *New York Times*, January 11, 2004.
- Executives at Air France and the French national railway admit that labor law has made it impossible to dismiss some employees they suspect of Islamic radicalization, who thus remain on the job. *New York Times*, February 20, 2016.

The sad irony is that even as the United States has moved rapidly toward more "European" labor policies, many countries in Europe itself, including Spain, Germany, and Portugal, have reacted to signs of growing dysfunction by reintroducing significant elements of free-market reform.

All of these changes were given teeth because private attorneys seeking damages and fees were beginning to propel many workplace disputes—akin to one of the roles formerly filled by unions but without unions' institutional commitment to stick around for the long term. With new causes of action and entitlements to damages multiplying, litigation—both by individual employees and in the form of class actions—grew steadily during the past half century, becoming a substantial share of the dockets of federal courts.

As lawyers pressed into the field, they discovered rich veins to exploit in older labor law as well. For example, the Fair Labor Standards Act of 1938 and similar state laws said that managers and professional employees generally did not have to be paid overtime. Did that category cover stockbrokers? Insurance agents? Junior news reporters? Companies that guessed wrong began paying out millions and even tens of millions of dollars in class action lawsuits. Disputes proliferated over whether one or another bit of work-related effort had to be kept on the clock or not. Were employers breaking the law by not putting employees on the clock for time spent donning and doffing work clothing? Looking at a spreadsheet while eating lunch? Taking a phone call from the office on the weekend?

How It All Backfires

Cato's Dan Mitchell has warned about this type of legislation, "There's no such thing as a free lunch. . . . If they push through something to make a certain class of workers more expensive, something will happen to adjust."

Mandating benefits, for example, tends to slow the growth of take-home pay, leaving the overall share of national income going to labor unchanged. When legal changes expand overtime entitlements, many employers can dodge a permanent upward jump in payroll costs by suppressing the level of base pay or rearranging schedules. When minimum wages rise, employers invest less in training and on-the-job amenities. And, of course, they employ fewer unskilled applicants and newcomers: indeed, notes economist Deirdre McCloskey, "The minimum wage arose in the early 20th century as a Progressive policy designed to [harm] low-wage workers." The nationwide federal minimum wage has also served as a weapon in sectional warfare, allowing economic interests from high-cost regions such as the urban Northeast to hinder the competitive escape of workplaces and jobs to lower-cost areas of the country.

Few policies make less sense than minimum wage laws as a way of assisting the poor. To begin with, most persons who hold those jobs live in families that are not poor: the average family income of minimum wage workers under age 25 is $65,900. The Congressional Budget Office analyzed a proposed rise in the federal minimum wage and found that only 19 percent of the rise in wages would go to families below the poverty line. So persuasive is the economic case against the minimum wage that a *New York Times* editorial in the 1980s famously bore the headline, "The right minimum wage: $0.00."

Discrimination law, too, often fails to confer the intended benefits on protected groups—or even makes things worse. Notoriously, labor force participation by disabled persons plunged after the 1990 enactment of the ADA, with its mandates for accommodation and other new sources of legal risk. When government makes it obligatory to underwrite costly benefits such as paid parental leave, employers tend to hire fewer persons they rationally predict are likely to use those benefits.

Of all these categories, age discrimination law may be the most self-defeating: the group most likely to wring money out of bosses through such claims is well-paid older males in managerial and professional jobs. Since the law passed, that very group has suffered one of the steepest declines in labor force participation, often replaced with involuntary joblessness. After all, why should an employer hire an expensive 61-year-old who might need a pricey buyout if things don't work out? Better to fish in other recruitment ponds.

Further defeating the assumptions of the carefully designed old regulatory schemes, new technologies, especially the Internet, have changed the structures of the workplace itself. The 1930s-vintage laws envisioned a workplace in which two classes of employee, workers and management, gathered at a designated factory or office building, clocked in and out at specific times (so that minimum wage and overtime obligations could be calculated), and got paid at regular two-week or monthly intervals by a single employer on whom new regulatory obligations could periodically be loaded.

Now, many of those distinctions have blurred. If you have five work tabs and six personal tabs open on your browser, are you "on the job"? Does it matter whether you are at your office station, taking a lunch break, aboard a plane, or stretched out on your sofa at home? What if your pay is assembled from multiple "gig" assignments with clients, rather than a single, stable boss? Even as computer-aided manufacturing has erased old lines between blue- and white-collar on the factory floor, so team organization concepts have blurred distinctions between managers, peers, and subordinates.

In a rational world, all of this should have led to a re-examination and often repeal of the old laws. The federal Fair Labor Standards Act, with its high-stakes litigation arising from elaborate guessing games about how to classify and categorize employees, should have been first to go. And while expected economic impact on protected groups is not the only reason for enacting employment discrimination laws, legislatures should

at least have revisited areas of the law where members of protected groups actually lost ground in the workplace after the law was extended to cover them—as with age and disability.

But no such luck. Critics of these laws mostly did not agitate for their repeal, and since the turn of the millennium, a newly invigorated left has taken up the slack and pushed for a massive, symbolic expansion of these laws—whether they work as intended or not. The most weirdly popular idea of all has been to hike the minimum wage to $15 an hour. That scheme does considerable economic damage even when enacted in cities with some of the nation's highest wage levels already, like New York, San Francisco, and Seattle. As a nationwide standard that would bind low-wage regions, the $15 notion is almost insane. In Mississippi, for example, the median wage for *all* hourly jobs is $13.76, which means the typical job would be out of compliance.

Among the Obama administration's signature initiatives was to use executive orders, administrative actions, and the nominally independent National Labor Relations Board to drive a much-intensified regime of labor and workplace regulation without asking Congress. The board, for its part, has extended labor-law liability across subcontractor and franchisee relationships, created new "ambush" election procedures to speed up unionization, declared insubordination to be a protected right, declared many common employer-handbook policies an unlawful entrenchment on collective action, tried to push temporary workers and religious college faculty into collective bargaining, and much more. Meanwhile, the Department of Labor has been no less active, pushing through a range of unilateral initiatives. The most controversial was a doubling of the salary threshold (from $23,660 to $47,476) below which most employers must pay time-and-a-half overtime to white-collar workers (it also indexed the new threshold to future advances in the wage level). Small businesses, restaurants, retail chains, finance, computer services, and colleges are among the sectors expected to be badly hurt by this move.

Like the earlier attempts at regulating the workplace, obligatory overtime pay for managerial and technical employees is pretty much guaranteed to backfire. With much more of the white-collar workforce on the clock, employers will be under legal pressure to revoke telecommuting arrangements, restrict access to company cellphones and email after business hours, and disallow "comp time" setups that make a day with the kids possible. Aside from sowing widespread disruption, the rules will frustrate ambitious individuals who tend to prefer the freedom and perks of salaried

status and willingly tackle long hours to learn skills and rise into management ranks. One big, if unstated, ideological aim is to get more people thinking of themselves as clock-punching subordinates, free from the politically unproductive "management mentality" of salaried types.

Who Is Harmed by the Fair Labor Standards Act?

Coverage of overtime and minimum wage debates tends to acknowledge that business and other employers are harmed. Sometimes the coverage also notes that workers are left idle by being priced out of jobs. But that's just the start. Others lose out as well:

- grocery co-ops that rely on member volunteers to stock shelves;
- developmentally disabled persons in community employment;
- workers asked to surrender company cellphones and stop using company online services after hours;
- elders for whom overnight home attendants, suddenly unaffordable under an overtime mandate, had been the alternative to nursing home care;
- restaurant, airport, and other service workers who made far more under a tip system;
- interns and first jobholders in competitive, sought-after fields like fashion journalism and political campaign work;
- drivers left with a choice of machine car wash or nothing because by-hand washes are unsustainable when a tip system gives way to a $15 minimum wage;
- disabled persons who rely on now-unaffordable personal care assistants;
- small wineries with community volunteer programs; and
- telecommuters recalled to in-office assignments only.

Why don't these groups and their experiences count for more in the legislative process?

Conclusion

The U.S. Constitution enumerates no general federal government power to regulate national labor markets. Congress should take its oath to the Constitution seriously and execute a broad retreat from this area.

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—Prepared by Walter Olson

63. Environmental Policy

Congress should

- repeal national air and water quality laws and regulations that involve localized pollution; and
- set a price on emissions or limits on the quantity of emissions and funnel the proceeds from the sales to those who are exposed to pollutants.

Current federal air pollution regulations are heavily influenced by concerns about particulate matter (PM). According to the U.S. Environmental Protection Agency (EPA), "particle pollution is made up of a number of components, including acids (such as nitrates and sulfates), organic chemicals, metals, and soil or dust particles." These emissions are linked to a number of different negative health effects. Reducing exposure to fine particulate matter often accounts for 90 percent of the estimated benefits of air regulations, according to the EPA.

How much should we reduce PM? Because pollution decisions necessarily involve one choice for many people, conflict arises when answering that question. Normal public-sector budgetary struggles result from participants having different preferences and willingness to pay for desired outcomes, with policymakers ultimately making choices that more or less correspond to the preferences of the median voter. But environmental policy conflict manifests itself as struggles over science. You can't just want cleaner (or dirtier) air because of your willingness (or lack thereof) to pay for it. Instead your preferences must be supported by scientific estimates.

Science plays a disproportionate role in environmental quality policy disputes because the federal Clean Air Act demands it. Every five years the EPA must prepare a document that "accurately reflects the latest scientific knowledge" on the health effects of exposure. It must then set

a standard that is "requisite to protect the public health, . . . allowing an adequate margin of safety" to ensure "an absence of adverse effect on the health of a statistically related sample of persons in sensitive groups." The Supreme Court ruled in 2001 in *Whitman v. American Trucking Association* that the Clean Air Act "unambiguously bars cost considerations from the [pollution limits]-setting process." Thus, EPA decisions on conventional pollutants are all about the benefits of emission reduction as ascertained by science because that is exactly what the law instructs the EPA to do.

Science also plays a disproportionate role in environmental policy because of political benefits. Delegating decisions to the EPA and "science" allows members of Congress not to have to make explicit decisions about environmental benefits and their costs.

Estimates of the effects of reduction in exposure to PM come from two studies: the American Cancer Society Study (ACS) and the Harvard Six Cities Study (SCS). The ACS follows 500,000 adults and the SCS follows 8,000 adults over time, estimating their relative risk of dying prematurely given their differing levels of exposure to PM.

The two studies have been the subject of much criticism. The Health Effects Institute, an air pollution research institute funded by both the EPA and the auto industry, reanalyzed the ACS study in 2000 and found anomalies. Increased PM exposure was associated with increased mortality for men but not women, those with high school or less education but not college graduates, and those who were moderately active but not sedentary or very active. Such variation is difficult to explain biologically.

When migration rates were included as a control variable in the statistical analyses, the PM effect disappeared. Cities that lost population in the 1980s were Rust Belt cities that had higher PM levels. People who migrated away from those cities were healthier and younger. The PM effect was more likely nonrandom migration away from older cities rather than an actual pollution-exposure effect.

Over time, PM levels have decreased and medical advances have increased. Thus, the reduction in mortality associated with fine-particle exposure also could be the result of better medical care rather than fine-particle reduction.

Pollution epidemiology research usually involves associations of *levels* of exposure with mortality rates. The association between higher PM concentrations and mortality rates is a cross-sectional relationship across cities with different levels of PM and different mortality rates. And yet the policy question is whether *changes* in exposure produce *changes* in

health outcomes. It is certainly true that mortality rates among the elderly are higher in locations that have higher PM levels. But *increases* in PM concentrations from one year to the next are *negatively* associated with changes in mortality.

As part of their policymaking, the EPA also uses a consulting firm to survey 12 experts (including three of the authors of the ACS and SCS studies) to ascertain their confidence in whether the statistical relationship between PM exposure and premature mortality found in the studies was causal. Four of the 12 experts said there was a probability of 10–65 percent that there was no causal relationship between PM concentration and mortality. Three experts said there was a 5 percent probability of noncausality, while another five experts said there was a probability between 0 and 2 percent. Only one of those five said there was a 0 percent probability of noncausality. Under the standard requirement of keeping the probability of false positive effects to less than 5 percent, the majority of the surveyed experts did not reject a null hypothesis of noncausality. A 95 percent confidence interval would include zero mortality effect for any reductions below 16 micrograms per cubic meter. Yet, despite this "science," in December 2012, the EPA set a fine-PM standard of 12 micrograms per cubic meter of air, to be met by 2020.

Scientific Disputes Signal Trading Possibilities

Critics of such regulation typically argue that "sound science" supports less stringent requirements. According to that view, if more people understood the tenuous nature of the evidence linking reduction in current pollution exposure to improved morbidity and mortality, political support for the current environmental policy regime would diminish.

But recent work by Yale law professor and cultural theorist Dan Kahan suggests that people's views about environmental policy relate to their cultural group identity, not scientific literacy. Those who are *more* scientific and numerate disagree *more* about environmental policy than those who are less informed. When acceptance of scientific evidence conflicts with group values, science loses and group values win.

So when you hear someone invoke the term "sound science," don't think of it as a call for another review of the literature by the National Academy of Sciences. Instead, think about "sound science" as a signal about a struggle over the initial allocation of property rights—that is, the right to differing levels of environmental quality—and the possibility that

people can realize large benefits from being able to trade those rights, even if they have strong preferences for different pollution levels.

In this view, the Clean Air Act gives implicit property rights to people who want very low pollution levels. Notice the language quoted above that the EPA must set standards that ensure "an absence of adverse effect on the health of a statistically related sample of persons in sensitive groups." Entities that would prefer a lower level of environmental quality would be willing to pay a large amount to have relaxed requirements. "Persons in sensitive groups"—that is, people especially concerned about pollution (e.g., asthmatics)—might well accept such a payment in lieu of the EPA-required emissions reduction.

From this perspective, the most important irrationality of environmental regulation is not its allocation of rights to a pristine environment backed by questionable scientific evidence, but its not allowing those initial decisions to be altered by subsequent trading. In this view, the role of government is to facilitate the development of secondary markets for public goods that would enable flows of money in the form of emissions fees or rights transfers that go directly from emitters to citizens in return for consent to change ambient air quality.

What level of government should facilitate such bargains? Before the nationalization of environmental policy in 1970, environmental quality was a local issue. Some areas were dirty and others were not. But under the imposition of federal pollution requirements in 1970, the cheapest way for local areas to comply was for them to mandate dramatically taller smoke stacks, which in essence transferred local pollution to downwind areas. As long as smokestack heights are low and transport is minimal, environmental quality is a local issue. Thus, the relevant unit of government to facilitate these bargains is probably at the metropolitan level.

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—Prepared by Peter Van Doren

64. Global Warming and Climate Change

Congress should

- reject any proposed tax on emissions of carbon dioxide;
- direct the administration to follow OMB guidelines in the calculation of the "social cost of carbon" and to use scenarios for future climate change that are consistent with observed environmental and climate change;
- direct the relevant federal agencies to phase out funding for general circulation climate model studies and terminate research support for so-called "impact studies" based upon those models; and
- determine that the Paris Agreement is a treaty and the Senate should vote for ratification or rejection under Article 2, Section 2 of the Constitution.

Several developments will create pressure for global warming legislation of some type in the coming congressional session. These include the Paris climate agreement, record high temperatures caused by the recent El Niño, the Obama administration's circumvention of the legislative process with regard to global warming policy, the Supreme Court's stay of the Environmental Protection Agency's (EPA) "Clean Power Plan," and calls for a tax on carbon dioxide emissions.

Reject a Tax on Carbon Dioxide Emissions

First and foremost, Congress should turn down any legislative proposals for a tax on carbon dioxide emissions, erroneously called a "carbon tax" by proponents. Such a tax would be as insidious as the income tax, which

began as a very small levy but ultimately evolved into the fiscal and byzantine morass that it is today. A carbon tax would do the same.

It is important to understand the flaws in arguments in favor of such a tax. Proponents argue that, if the tax is implemented, the EPA will agree to no further regulation of carbon dioxide emissions. That is highly unlikely. To gain political approval for the tax, the rate will initially be set very low—so low that it will have virtually no detectable effect on emissions. At the same time, to comply with what it feels is the spirit of the 2007 Supreme Court decision on greenhouse gases in *Massachusetts v. Environmental Protection Agency*, the EPA will have to continue to enforce existing regulations, including the controversial Clean Power Plan. Nonetheless, proponents argue that the EPA will actually terminate all existing regulations on carbon dioxide emissions. The same logic applies: initial tax rates will be so low that existing regulations simply cannot be eliminated.

The Clean Power Plan was originally envisioned as a way to replace vast amounts of coal-generated electricity (which account for roughly one-sixth of all U.S. carbon dioxide emissions) with natural gas, which emits 60 percent less carbon dioxide than coal per unit of electrical output. The cost and maintenance of a natural gas plant is also much lower than that of a coal-fired unit. The Clean Power Plan solution seemed palatable to virtually all parties. But in its final rulemaking, the EPA abandoned that plan in favor of more and more solar and wind power, which are not acceptable because of unreliability and expense.

Carbon tax advocates argue that such a tax could be "revenue neutral" inasmuch as other federal taxes, such as the income tax, would be reduced by the equivalent amount of revenue generated by the carbon tax. That is a fantasy. Legislators will never give up an equivalent amount of revenue that they could spend on desired projects. The Heritage Foundation's David Kreutzer put it another way: we can't "expect three trillion dollars to walk down K Street unmolested" by special interests and lobbies.

Operationally, the carbon dioxide tax also fails. Proponents like to point out the experience in the province of British Columbia, where gasoline sales fell even more than predicted following the enactment of a carbon dioxide tax, even as economic growth continued. What really happened, though, is that residents, many of whom live very close to the U.S. border, simply drove over the line for fuel. And British Columbia's economic growth, which had been leading Canada, rose less than in the other populous provinces.

Supporting a carbon tax is politically and economically perilous. Congress should reject any proposals to enact one.

Direct the Administration to Recalculate the "Social Cost of Carbon"

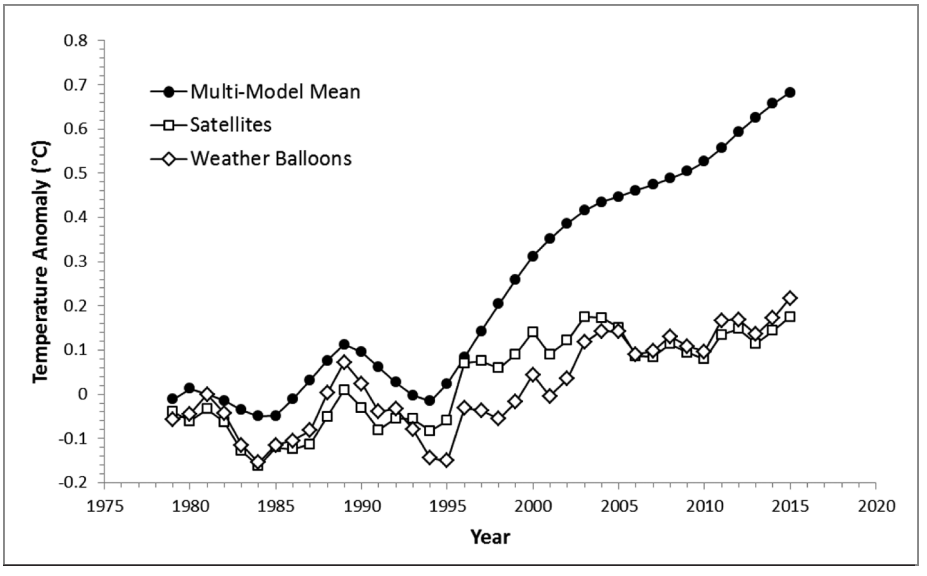
Proponents of a carbon dioxide tax say that the cost of carbon dioxide emissions to society is so great that a tax is needed to redress a heretofore large and uncompensated environmental externality. They cite something called the "social cost of carbon" (SCC). But the way that the Obama administration calculated this figure contravenes a large number of physical, biological, and regulatory realities. As a result, Congress should direct the new administration to follow the explicit Office of Management and Budget (OMB) guidelines in calculating the SCC, including guidance on how to select discount rates, as well as requirements for reporting domestic (vs. global) costs. Additionally, the federal SCC determinations must fully incorporate the latest scientific estimates of the sensitivity of the earth's temperature to carbon dioxide increases and adequately incorporate the overwhelming scientific evidence of the positive effects of carbon dioxide on global food production and vegetation growth.

The Obama administration's SCC was generated by a federal Interagency Working Group (IWG) that ignored specific OMB directives with regard to the determination of the SCC and its use in cost-benefit analysis of federal actions. OMB Circular A-4 (2003) presents clear guidelines "designed to assist analysts in the regulatory agencies by defining good regulatory analysis . . . and standardizing the way benefits and costs of Federal regulatory actions are measured and reported." Among the guidelines for "good" analysis are directions for selecting an appropriate discount rate for calculating future costs and/or benefits. The circular explicitly states, "For regulatory analysis, you should provide estimates of net benefits using both 3 percent and 7 percent"—with a discount rate of 7 percent representing "an estimate of the average before-tax rate of return to private capital in the U.S. economy" and 3 percent reflecting the low case. Instead, the IWG applied discount rates of 2.5, 3, and 5 percent in determining the present value of its estimate of the projected future costs resulting from carbon dioxide emissions—leaving out entirely an analysis using a 7 percent discount rate. Had the IWG included a 7 percent discount rate as guided by the OMB, they would have arrived at a substantially lower estimate of the SCC—some 80 percent (or more) below the current IWG mean SCC value.

Additionally, OMB Circular A-4 recommends, in calculating costs and benefits, "Your analysis should focus on benefits and costs that accrue to citizens and residents of the United States." Yet the administration's IWG reports (and subsequently relies upon) a value of the SCC determined from the accumulation of costs projected to occur across the *globe* while burying the U.S. domestic costs (which are estimated to be only 7 to 23 percent of the global value). Congress should direct the IWG to strictly follow the OMB guidelines and to highlight the costs and benefits carbon dioxide emissions have on U.S. citizens and residents.

An accurate cost-benefit analysis can only be done if there is a reliable forecast for climate change and its specific impacts. The IWG, by relying on the output from published general circulation models (GCM) that simulate future climate as carbon dioxide is added to the atmosphere, is saying that those models are sufficient. They are not. Figure 64.1 shows the temporal evolution of the global average temperature of the lower-atmosphere simulated by the suite of climate models used by the United Nations' Intergovernmental Panel on Climate Change (IPCC), compared

Figure 64.1
Lower-Atmosphere Temperatures Predicted by IPCC Models and Measured by Satellites and Weather Balloons



SOURCE: Adapted from John R. Christy, Testimony before the Committee on Science, Space, and Technology, U.S. House of Representatives, February 2, 2016.
NOTE: IPCC = Intergovernmental Panel on Climate Change.

with weather balloon–sensed and satellite-measured temperatures of the same region, which is predicted to experience substantial warming from increased carbon dioxide emissions.

The most logical interpretation of the ongoing (and increasing) disparity between the collectively modeled and observed temperatures (as shown in Figure 64.1) is that the forecast models are simply too sensitive to carbon dioxide changes. The IPCC's forecast global warming is 3.2°C (5.8°F) for doubling atmospheric carbon dioxide, whereas a growing body of the scientific literature, beginning in 2011, forecasts around 2.0°C (3.6°F). Several credible estimates are even lower, with a median value of 1.3°C (2.3°F). Congress should direct the IWG to recognize and incorporate these scientifically demonstrated lower forecasts of warming into its determination of the SCC—something that the IWG has thus far strongly resisted.

Additionally, Congress should direct that all SCC calculations take into account the massive increase in global food production (valued at $3.2 trillion since 1950) that is a direct result of increasing atmospheric concentrations of carbon dioxide, as well as the nearly global increase in green vegetative matter. The current models used by the IWG to determine the SCC are woefully insufficient on these accounts.

Had the IWG followed the OMB guidelines for selecting the discount rate and focused on domestic costs, and had they incorporated the latest and robust scientific findings indicating a lower climate warming and the carbon dioxide fertilization of plant life, then the social "costs" of carbon would have been greatly reduced and, in some cases, even moved into "benefits" territory.

Congress should insist on a new, more accurate, and complete analysis of the SCC from the IWG, the results of which would engender a reexamination of the cost-benefit analyses underlying a large and growing body of federal regulations.

Phase Out Funding for Large-Scale Climate Modeling

Congress should phase out funding for large-scale climate modeling and application of those models. More than four decades of spending has resulted in no improvement in the precision of future forecasts. It is noteworthy that the Australia's Commonwealth Scientific and Industrial Organization, which oversees all government-funded science there, terminated climate model funding in 2016, although it did so by declaring

"success" in modeling rather than acknowledging the lack of any increase in precision.

Figure 64.1 demonstrates the failure of the current suite of climate models (general circulation models). Indeed, it has been known since the late 1980s (and acknowledged by the IPCC over 20 years ago) that GCMs predict too much warming when increases in atmospheric carbon dioxide drive climate change. At that time, the United Nations offered two alternative explanations: (1) the model forecasts were simply too warm, or (2) the forecast warming was being "hidden" by other anthropogenic emissions that counteract it.

Rather than admit the systematic failure of the GCMs, climate modelers embraced the second explanation—specifically that particulate aerosols (e.g., sulfates), which are largely a product of the combustion of coal, are counteracting warming. Recent peer-reviewed research demonstrates that this is not the case. Rather, forecasts are simply too warm.

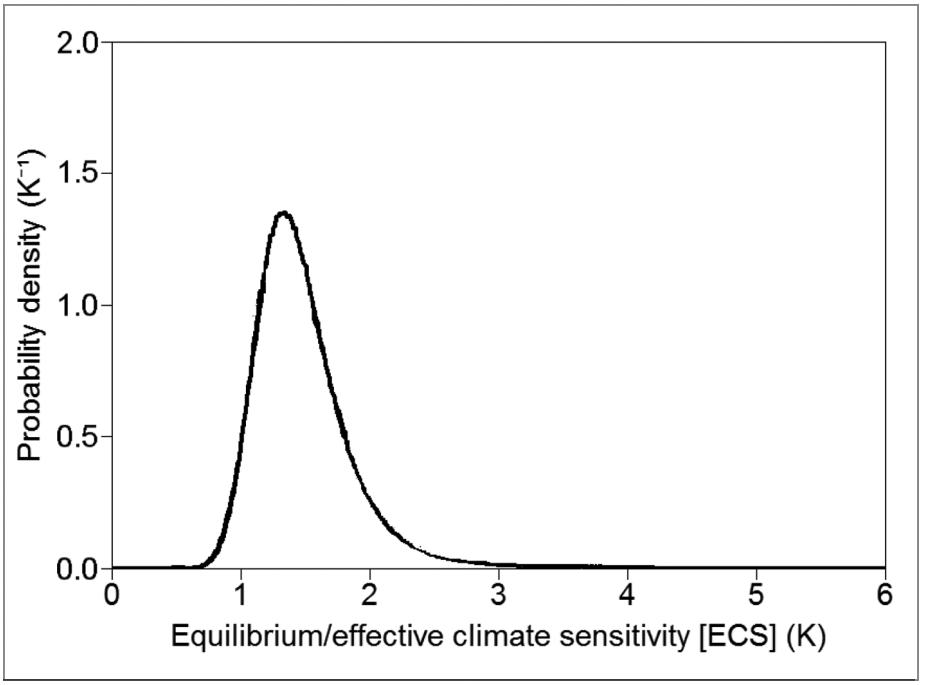
This estimate is shown in Figure 64.2 as a probability function. The most likely value (1.3°C) is the peak in the curve, and it is clear that the probabilities of much higher (and costly) warming are now vanishingly small. This dramatic improvement in narrowing the range of likely warming was *not* generated using the climate models, but rather is based upon observed history over the past century and a half.

Figure 64.3 shows the global average temperature change projections from all the GCM runs in the 2013 IPCC report, out to 2050. The average warming predicted for 2001–2050 is slightly more than 1.3°C (2.3°F). But the scatter between the models is enormous by then, with the 95 percent confidence limits of the net warming ranging from 0.6°C (1.1°F) to around 2.2°C (4.0°F) above the 1986–2005 average.

Such a large spread (and large forecast rise compared with observations) is an indication that GCMs are, as a family, useless for policymaking. Congress should review the various compendia of climate change literature beginning with the 1975 National Academy of Sciences report, *Understanding Climate Change*. That review will reveal that the range of future warming projected in early reports is not significantly different than what is shown in Figure 64.3. After more than four decades and billions of dollars spent on a concentrated federal effort in GCM modeling, the models' forecasts have not improved and are increasingly at variance with observed warming. It is time for Congress to put an end to this charade by curtailing the pumping of taxpayer dollars into this abyss.

A remarkable finding published in 2016 by the Royal Society, the national academy of science of the United Kingdom, may explain the

Figure 64.2
Probability Density Function of Mean Surface Warming for Doubled Atmospheric Carbon Dioxide



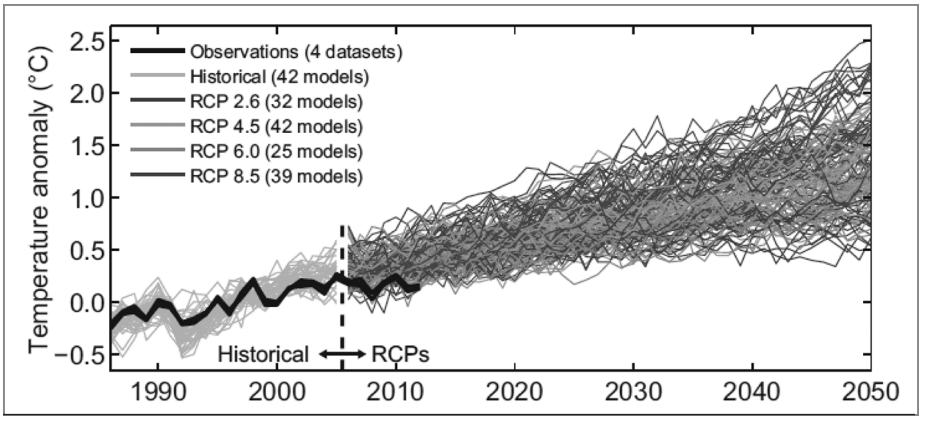
SOURCE: Adapted from Nicholas Lewis, "Implications of Lower Aerosol Forcing for Climate Sensitivity," *Climate Etc.* blog entry, March 19, 2015.

time and money spent. It shows that the way we reward scientists is producing, in the authors' words, increasingly "bad science." A corollary is that, if the federal government suddenly disburses enormous amounts of funding for a given field, as it has for climate studies, then the quality of research will decline significantly.

It is a common practice to use GCMs to provide a forecast, which is then used to calculate "impacts" of climate change, such as the effect on a nation's agricultural output. This type of "impacts" literature is voluminous, as evidenced by the quadrennial "National Climate Assessments" of the impact of climate change on the United States, published by the U.S. Global Change Research Program.

Clearly, using failing climate models to drive impact studies will produce an exaggerated response since the models themselves are too warm (see Figure 64.1). Further, the recent study published by the Royal Society, noted above, implies that exaggeration will be more the norm than the

Figure 64.3
Projections of IPCC Climate Models Compared with Observed Temperatures



SOURCE: Adapted from Intergovernmental Panel on Climate Change, *Climate Change 2013: The Physical Science Basis*. New York: Cambridge University Press, 2013.
NOTE: IPCC = Intergovernmental Panel on Climate Change; RCP = representative concentration pathway.

exception. Consequently, Congress should direct the appropriate agencies to phase out this highly misleading "impact" research.

Ratify or Reject the Paris Agreement

Congress should determine that the Paris Agreement on climate change is a treaty subject to ratification by the Senate under Article 2 of the Constitution, and the Senate should request that the president submit it for consideration. On December 12, 2015, the Paris Agreement on climate change was introduced before a plenary session of the 21st Conference of the Parties to the United Nations' Framework Convention on Climate Change. It was to be presented for a voice vote for acceptance or rejection. In a very unusual action, U.S. Secretary of State John Kerry voiced an objection over a portion of Article 4.4. The language in question stated, "Developed country Parties *shall* continue taking the lead by undertaking economy-wide absolute emission reduction targets" [emphasis added]. He explained that this language changed the Agreement from an "executive agreement" into a treaty, which would require a two-thirds vote in the Senate for adoption. The office of the French presidency, which was in charge of the December meeting, eventually decided that this was a "typographical error."

However, the word "shall" appears in 142 other instances in the agreement, and some of these apply directly to developed countries such as the United States. For example, Article 9, paragraph 1 states, "Developed country Parties shall provide financial resources to assist developing country Parties with respect to both mitigation and adaptation in continuation of their existing obligations under the Convention." Clearly, that language directs countries to provide funding to developing nations. In the United States, that means spending taxpayer dollars, which can only be appropriated by Congress unless compelled under a treaty ratified by a two-thirds vote of the Senate—as laid out in Article 2 of the Constitution.

Article 7, section 13 of the agreement also commits the United States to financial support for the developing world: "Continuous and enhanced international support shall be provided to developing country Parties." Article 9, section 5 even refers to the payment of taxpayer dollars specifically: "Developed country Parties shall biennially communicate indicative quantitative and qualitative information related to paragraphs 1 and 3 of this Article, as applicable, including, as available, projected levels of *public financial resources to be provided to developing country Parties*" [emphasis added].

It is therefore incumbent upon Congress to emphatically state that the Paris Agreement is a treaty. The Senate should then request that the president forward the treaty for a ratification vote. And the Senate should then reject it.

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—Prepared by Patrick J. Michaels and Paul C. Knappenberger

Foreign and Defense Policy

65. Restoring Prudence and Restraint in U.S. Foreign Policy

Policymakers should

- question the key assumptions that have guided U.S. foreign policy since the end of the Cold War;
- have a better appreciation for the limits and unintended consequences of the use of U.S. military power;
- be mindful of the American people's attitudes on foreign policy, including their deep skepticism of land wars in the Middle East and resentment of the free-riding and reckless behavior of allies in Europe and Asia; and
- adopt a foreign policy, consistent with the nation's founding traditions, that capitalizes on America's key advantages and is better aligned with public sentiment today.

Since the end of the Cold War, the United States has embraced a heavily interventionist and increasingly militaristic foreign policy. The belief in this grand strategy among foreign policy elites only accelerated after the terrorist attacks of September 11, 2001. This strategy, known loosely as liberal hegemony or international primacy, purports to use U.S. military power to shape the international order, as opposed to merely defending the United States and its vital interests.

Some experts, however, have long questioned the wisdom of primacy. Their voices are now being heard, even in policymaking circles, as the high costs and dubious benefits of this policy come into sharper focus. They argue that primacy is built on flawed assumptions and is ultimately counterproductive to U.S. safety. By discouraging other countries from doing more to defend themselves and their interests, primacy imposes excessive costs on American taxpayers and unnecessary risks on U.S. troops.

Meanwhile, primacy increases the likelihood that the United States will be drawn into wars that do not serve U.S. vital security interests.

The United States should adopt a different grand strategy, one that maintains a superior defense capability focused on advancing American security. Restraint takes advantage of America's essential security and favorable strategic position. It also recognizes that excessive intervention—especially the use of military force—unleashes a host of unintended consequences that often undermines U.S. national security. Restraining the impulse to intervene militarily or diplomatically when U.S. vital interests are not threatened would reduce the likelihood that we will be drawn into foolish wars and would also provide a powerful incentive for allies to share the burdens of defense.

The Problem with Primacy

The object of U.S. foreign policy in the post–Cold War world, according to a Pentagon planning document prepared in 1992, was to "prevent the emergence of a new rival." U.S. military power would not merely deter attacks against the United States, but would also deter potential challengers, including traditional U.S. allies such as Germany and Japan, from aspiring to play a larger role in their region, or globally.

Several years later, Robert Kagan and William Kristol made the case for "benevolent global hegemony," their particular brand of primacy. They called for frequent military interventions to topple "rising dictators and hostile ideologies" and were especially keen to reject the idea that the U.S. military should focus on defending the United States. Instead, they supported going to war even "when we cannot prove that a narrowly construed `vital interest' of the United States is at stake."

At least four key assumptions underlie primacy. First, primacy holds that technology has rendered moot our traditional geographic advantages: friendly and weak neighbors to the north and south, and wide oceans to the east and west. The world is plagued by disparate and urgent threats. Any problem, anywhere, *could* threaten America in the future. Therefore, U.S. national security policy under primacy aims to prevent all fires before they start. If that fails, the U.S. military is prepared to stomp them out.

Second, primacy asserts that the United States must take upon itself the burden of defending allies around the world. Though such a strategy can encourage free riding, primacy advocates are more worried by the prospect that allies' self-defense efforts might fail, necessitating more costly U.S. intervention later and under less favorable circumstances. U.S. security

guarantees, the primacists say, tamp down the natural inclination of states to want to provide security for themselves, thus preventing allies from arms buildups that might unsettle their neighbors and perhaps even unleash regional arms races.

A third assumption undergirding primacy is the belief that the proper functioning of the global economic system requires a single dominant state to enforce the rules of the road. Because the health of the U.S. economy depends upon a healthy global economy, primacy ensures both our physical and economic security.

Finally, primacy ascribes a high level of effectiveness to the use of military force. Beyond the deterrent and coercive effects of preponderant military power, primacists believe that military force is the solution to a wide range of foreign policy problems. Since the 1990s the United States has used its military to provide humanitarian aid, topple governments, impose democracy, help rebuild national economies, do police work and peacekeeping, and of course find and kill members of terrorist groups. Despite the length of that list, however, many primacists believe the United States should be using military force in even more places than it is presently.

The result of primacy's core assumptions is an expansive definition of American national interests that encourages aggressive behavior and generates high costs without adding to America's national security. The American response to 9/11 has cost the United States somewhere between $4 and $6 trillion to date as the “war on terror” spread from Afghanistan to Iraq to Somalia, Syria, Libya, Yemen, and Pakistan. Meanwhile, the men and women in our military are regularly deployed far from our shores, and they have often paid a terrible price. Thousands have been killed in the wars in Iraq and Afghanistan, and tens of thousands have been injured. Nearly a million veterans have registered for disability claims from these two wars.

Such sacrifices might be justified if they obtained the fundamental object of *any* nation's foreign policy: security. Tragically, the United States has little progress to point to for all its efforts. The Islamic State of Iraq and Syria (ISIS) was born from the chaos in Iraq after the U.S. invasion, the number of jihadists and terrorist attacks in the Middle East has exploded since 2001, and all the countries in which the United States has engaged militarily are in shambles. Rather than solve problems, the primacist approach toward terrorism and the Middle East has made things worse while creating new enemies and giving more people an incentive to conduct terrorist attacks against the United States.

The Benefits of Restraint

In stark contrast, the strategy of restraint is premised on very different assumptions about the way the world works. First, the restraint perspective asserts that the United States enjoys a fundamentally benign security environment. The fears that drive primacy's hyperactivity are mostly exaggerated or overblown. Technology has not evaporated the seas. Large land armies cannot invade and occupy the United States. Meanwhile, potential challengers such as China or Russia face a number of problems that will constrain their ability to cause trouble, especially in the Western Hemisphere.

In other critical respects, technology enhances U.S. security. Nuclear weapons are a powerful deterrent against state actors with return addresses. Meanwhile, precision weapons and special operations forces can be used against terrorists and nonstate actors. The hard part is finding them and stopping them before they act, but intelligence and law enforcement personnel are in the best position to do this. Large land armies stationed in foreign lands may generate more terrorism than they cure.

Second, restraint also departs from primacy on assumptions about allies and regional security efforts. Thanks to favorable geography and other advantages, America doesn't need to maintain regional balances of power to ensure its security. In fact, commitments to reassure nervous allies, deter attacks against others, and use the military to fight our allies' enemies if deterrence fails pose a number of important challenges. Alliances, especially with countries in dangerous neighborhoods, can inadvertently increase the likelihood of conflict, as well as the likelihood of American involvement. Allies are often more willing to confront powerful rivals than they would be if they were responsible for their own defense, a classic case of moral hazard, or what Barry Posen at the Massachusetts Institute of Technology calls “reckless driving.” There have always been dangers in the world, and there always will be. But primacy compounds the problem by essentially making everyone else's problems our own.

Third, restraint takes seriously the importance of global engagement through trade but rejects the primacists' claim that such economic interactions can only occur under the American security umbrella. The international economic order is remarkably resilient. Temporary supply or demand disruptions occur all the time. Natural disasters such as hurricanes and earthquakes, or human-caused mischief such as war or banditry, can cut off the flow of oil from a particular refinery, for example, or threaten shipping through critical strategic waterways. But markets adapt. Producers

respond to incentives and bring new sources of supply online. Supply routes can also be adjusted, circumventing closed or threatened transit corridors. Consumers adjust as well, substituting products as the price and availability change. Meanwhile, primacy's frequent wars have disrupted markets as much or more than the terrorists and rogue states have.

Finally, restraint also challenges primacy's confidence in the effectiveness of military force. A review of the past 20 years reveals that, although military force has been highly effective for achieving military objectives, its effectiveness in nonmilitary domains is extremely limited. Spreading democracy, nation building, resolving civil wars, and fighting terrorism are all well beyond the capabilities of even the American military. Moreover, as the experience in the Middle East since 9/11 has shown, military intervention can also make things worse by causing chaos and instability, creating new enemies, and fostering resentment among foreign publics.

A restraint-oriented grand strategy would be very different from the current American strategy. It would focus on defending U.S. vital interests, maintaining a force capable of deploying abroad when the need arises, and restraining the impulse to use that military power when U.S. vital interests are not directly engaged. And it would call on others to deal with urgent threats to their national security before they threaten their region or the globe.

Conclusion

American grand strategy should flow from an assessment of strategic realities. Primacists' assessment of these realities has been faulty. As a result, the pursuit of primacy has been the biggest threat to American security and its national interests since the end of the Cold War. Primacy is costly, dangerous, unnecessary, and counterproductive. In inflation-adjusted dollars, the United States annually spends more on its military today than during an average Cold War year. The United States accounts for nearly 40 percent of the world's military spending even though Americans produce just over 20 percent of global economic output and represent just 5 percent of the world's population. We spend more than twice as much on national security as China, Russia, Iran, and North Korea—combined.

In contrast, a strategy of restraint would allow the United States to reap the benefits of its benign security environment at much lower costs in lives and national treasure. Withdrawing from the painful and expensive history lessons of Afghanistan and Iraq and staying out of other local

conflicts will save American lives and the tens of billions of dollars spent each year. Letting its allies take responsibility for their own security will reduce the chances that the United States gets drawn into another nation's conflicts. A commitment to self-defense and diplomacy rather than confrontation and military force will help the United States regain much of the moral high ground and soft power that it has lost over the past two decades.

Beyond these points, restraint is consistent with U.S. foreign policy as it was practiced for most of the nation's history. For over a century, U.S. policymakers and diplomats followed George Washington's guidance from his Farewell Address: "The great rule of conduct for us, in regard to foreign nations," he explained, "is in extending our *commercial* relations to have with them as little *political* connection as possible." Washington and the other Founders desired amicable relations with other countries, were anxious to trade with others, and hoped to welcome immigrants to our shores. But they were equally anxious to avoid foreign wars.

Their advice would still serve us well today. A wise grand strategy in the 21st century must take account of the resources available to execute it. It should prioritize threats and contemplate the optimal tools for addressing them. The ends are often more malleable than the ways and means. Primacy pretends that they are not. It fails to prioritize, predicated as it is on the notion that any threat, anywhere, is a matter of urgent concern for the United States. That view requires a massive, active military, one even more expensive and more active than the one we have today.

In the current domestic political context, in which U.S. federal government spending is rising faster than revenues, increasing the resources going to the Pentagon entails telling the American people to accept cuts in popular domestic programs, higher taxes, more debt, or all of these things. Primacy suggests that these difficult choices cannot be avoided. It expects Americans to make sacrifices while our allies continue to neglect their defenses and maintain their bloated domestic spending programs.

Such an approach is, unsurprisingly, deeply unpopular with the American people. "Defending our allies' security" ranked near the bottom of Americans' foreign policy priorities, tied with "limiting climate change," in the Chicago Council on Global Affairs' most recent report on American public opinion and foreign policy.

After years of war in the Middle East with no end in sight and little to show for it but pain and more terrorism, the overwhelming majority of Americans now believe that neither the Afghanistan nor the Iraq invasion

was worth the costs. The number of Americans who believe that the United States should mind its own business internationally is near an all-time high. Though Americans certainly appreciate and want the United States to maintain superior military capability, most believe that few situations justify the sort of military intervention that has characterized the past 20 years of American foreign policy. Absent a clear and present threat to national security, the public prefers diplomacy and other tools over the use of force as a means of dealing with international problems.

Rather than clinging stubbornly to an unnecessary and unwise strategy of primacy, policymakers should reconsider America's global policing role, encourage other countries to defend themselves and their interests, and bring the object of our foreign policy in line with the public's wishes.

Suggested Readings

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—Prepared by Christopher A. Preble and A. Trevor Thrall

66. Countering Terrorism in the United States

Policymakers should

- begin all security policy discussions with an elemental question: "How safe are we?";
- consider that, even with 9/11 included in the count, an American's chance of being killed by a terrorist is about 1 in 4 million per year;
- be wary of counterterrorism policies that are not backed up by the sound analytic procedures routinely applied to other hazards;
- increase governmental efforts to perform and publish such analysis, especially in the Department of Homeland Security; and
- cancel or modify homeland security programs with costs that outweigh benefits.

When seeking to create policies to deal with any hazard that threatens human life and to expend funds, the single most important question to ask at the outset is also one that is almost never put forward when formulating policy about terrorism. It is not "Are we safer?" but "How safe are we?"

In the United States from 1970 through 2015, the odds of an American being killed by a terrorist (of any sort) were 1 in 4 million per year. Those low numbers lead to the question posed shortly after 9/11 by risk analyst Howard Kunreuther: "How much should we be willing to pay for a small reduction in probabilities that are already extremely low?"

Questions like Kunreuther's are too rarely asked within the U.S. government. A 2010 assessment by a committee of the National Academy of

Sciences concluded that domestic counterterrorism funds were expended without serious analysis of the sort routinely required in other areas of government, or even the sort carried out by the Department of Homeland Security (DHS) itself for natural hazards. The committee could not find "any DHS risk analysis capabilities and methods" adequate for supporting the decisions made.

Extensive and transparent efforts to evaluate counterterrorism expenditures in the United States are long overdue. Instead, policymakers have maintained their alarmist perspectives and perpetuated vast and hasty increases in spending on homeland security.

It is possible to apply standard cost-benefit and risk-analytic procedures of the sort called for by the National Academy committee. These procedures have been developed, codified, and increasingly used as an aid in responsible decisionmaking for decades—or in some respects, for centuries. And they have been applied to a wide variety of hazards, including ones that are highly controversial and emotive, such as pollution, chemical power plant accidents, and exposure to nuclear radiation.

One of these approaches involves the concept of "acceptable risk," a phrase that has been almost completely neglected in discussions about counterterrorism expenditures. Risks tend to be deemed acceptable if they cause death in fewer than 1 in 1 million or perhaps 1 in 2 million cases per year. Hazards that fall into the unacceptable range (traffic accidents, for example) should generally command the most resources, whereas less should be spent to combat hazards in the acceptable range (drowning in bathtubs, for example).

If the threat that terrorism presents to human life in the United States is—in that sense—"acceptable," then efforts, particularly expensive ones, to further reduce its likelihood or consequences are unjustified. Spending on more smoke alarms, tornado shelters, car safety, and other measures would save far more lives.

Another approach is to calculate how many lives domestic counterterrorism expenditures would need to save to be justified. Following widely applied procedures, a study for DHS concluded that the best estimate of the value of a saved human life for homeland security measures would be about $15 million. Under that stipulation, domestic counterterrorism spending ($72 billion across the government in 2016, according to the Office of Management and Budget) would be worthwhile if it prevented some 4,800 terrorism deaths in the country each year. That figure seems to be very high: even with the San Bernardino and Orlando tragedies

included in the count, Islamist extremist terrorists in the United States have killed about seven people a year since 9/11.

Yet another approach is a full cost-benefit analysis. This analysis could seek to determine, for example, how many terrorist attacks the increase in expenditures since 9/11 would have had to deter, disrupt, or protect against to be justified. The number turns out to be quite high: 150 attacks like the Boston Marathon bombing each year—about one every other day; or 15 attacks per year like the one in 2005 on the London transportation system—more than one a month; or about one 9/11 attack every three years. Similarly, methods of protecting a standard office building are cost-effective only if the likelihood of a sizable terrorist attack on the building is a thousand times greater than it is at present. Assessed individually, some security measures, such as hardening airline cockpit doors, do seem to be cost-effective whereas others, like the Federal Air Marshal Service, don't.

A defender of current spending might argue that the number of deaths from terrorism is low primarily because of the counterterrorism efforts. But, although those measures should be given some credit, it is not at all clear that they have made a great deal of difference.

To begin with, the people prosecuted on terrorism charges in the United States do not seem to be all that capable. The RAND Corporation's Brian Jenkins' assessment is apt: "their numbers remain small, their determination limp, and their competence poor." Left on their own (and absent help by infiltrating operatives from the Federal Bureau of Investigation), it seems likely that few, if any, of them would have actually been able to cause much damage.

In addition to those prosecuted on terrorism charges, authorities have encountered a considerable number of people who seem to be aspirational terrorists. Lacking enough evidence to convict these individuals on terrorism charges, prosecutors have levied lesser ones to put, or send, the perpetrators away. However, these people are even less likely than those charged with terrorism to be willing and able to carry out attacks. Because they receive short sentences, many have been released; but few, if any, have even *tried* to commit a terrorist attack since release. It is clearly not a very determined bunch.

Finally, we are often told that security measures deter terrorists. Some targets—airliners and military bases, for example—may indeed have been put out of reach by security measures. But no dedicated terrorist should have much difficulty finding other ones if the goal is to kill people, destroy property, or get attention. Suitable targets are everywhere.

These considerations are based on history, and there is no guarantee that the frequencies of the past will persist into the future. Things could become worse. However, it is up to those who hold such a view to explain why they think terrorists will suddenly get their act together and become capable of massively increasing their violence in the United States.

The terrorist threat as it currently exists does not justify the hundreds of billions that have been spent on it since 9/11. If, as is likely, policymakers will not undertake cuts, they should at least require DHS to conduct more rigorous cost-benefit analyses of its programs.

Suggested Readings

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—Prepared by John Mueller

67. Countering Terrorism with Targeted Killings

Congress should

- suspend or drastically reduce targeted killings, as executed by drone strikes and special operations forces, in Pakistan, Somalia, and Yemen;
- rely instead on more indirect methods of counterterrorism, such as military assistance for foreign forces combating terrorists, or nonmilitary methods, such as intelligence operations;
- require the military, Central Intelligence Agency, or a congressional panel to publish studies on the efficacy of lethal counterterrorism methods, especially targeted killings by drone strikes;
- hold oversight hearings on those studies; and
- vote on authorizing the use of force in nations where targeted killings might occur and include geographic, temporal, and possibly other limits in the authorizing language.

Although the phrase "war on terrorism" has fallen out of rhetorical favor in Washington in the 15 years since the 9/11 attacks, the war is still going strong. U.S. forces today target terrorists in seven foreign nations. Nearly 10,000 U.S. troops remain in Afghanistan, fighting Taliban militias as well as a splinter group claiming affiliation with the Islamic State of Iraq and Syria, or ISIS. U.S. airstrikes, aided by small numbers of U.S. ground troops, are attacking ISIS in Iraq and Syria. U.S. aircraft recently commenced bombing the ISIS-affiliated group in eastern Libya. And U.S. unmanned aerial vehicles (drones) target terrorists amid those wars and in Pakistan, Yemen, and Somalia, where they are aided by U.S. special

operations forces who identify airstrike targets, support local forces, and occasionally conduct killing raids.

This chapter evaluates those U.S. efforts to combat terrorists outside larger wars, focusing on armed drones and the gray area between peace and traditional warfare that they inhabit. According to the Bureau of Investigative Journalism, the United States has conducted 424 drone strikes in Pakistan, 136–156 in Yemen, and 32–36 in Somalia between 2002 and October 1, 2015, collectively killing between 3,318 and 5,288 people, 10–20 percent of them civilians. Both the military, through Joint Special Operation Command, and the Central Intelligence Agency (CIA) conduct the strikes, primarily using Predator and Reaper drones armed with Hellfire missiles. A recent Obama administration decision is reportedly shifting the CIA out of that paramilitary role.

Keep in mind that drones are weapons serving a policy of targeted killing. That policy is what is evaluated here. The general utility of drones for the U.S. military—where they are primarily used as surveillance platforms—is not the subject. Nor does this chapter analyze the wisdom of the wars in Afghanistan, Iraq, and Syria, which other chapters in this volume cover.

Evaluating the efficacy of targeted killings to counter terrorism is difficult for several reasons. One is the murky nature of counterterrorism policies. Observing and measuring their effect requires some information about the operations and motivation of terrorist organizations, which is not something that terrorists eagerly share. The risks of targeted strikes, meanwhile, come in forms that resist measurement, such as militants' motivation to attack the United States.

The other obstacles to evaluation result from institutional dysfunction in the U.S. government: excessive secrecy and anemic oversight. Some secrecy is necessary, of course, to protect intelligence sources and methods. But our government uses secrecy to prevent people from second-guessing its policies. The Obama administration refuses to divulge even its general strategic and legal reasoning concerning the targeted killing of terrorists.

That abuse of secrecy undermines Congress's ability to provide oversight. Members of Congress cannot meaningfully oversee policy without being able to publicly critique it. And that would bother Congress were it inclined to scrutinize U.S. wars. But Congress allows the executive branch to launch strikes on terrorists as it sees fit, under the dubious legal authority of the 2001 Authorization for Use of Military Force. That law actually authorizes the use of force only against the perpetrators of the 9/11 attacks

and those who aided or harbored them. A Congress more jealous of its war-making powers would hold hearings before authorizing strikes against a new group or nation. Those hearings could force the administration to explain its rationale for strikes.

Evaluating Success

These circumstances—the inherent difficulty of evaluating counterterrorism policy and the government's refusal to help—make evaluation of counterterrorism programs rough and uncertain. Still, to assess the worth of counterterrorism programs, we must weigh their costs and benefits, however speculatively. What follows is an outline of such an evaluation, first considering possible benefits and then potential costs.

"Benefits" here means successful counterterrorism—terrorism that did not occur. That is different than attacking or even killing terrorists. Defenders of targeted killings, especially executive branch officials, tend to conflate strikes with counterterrorism, muddling means and ends, presumably because the former is easier to measure.

A program's benefits should be measured by comparing its results to what would occur in its absence. That may seem obvious, but advocates of drone strikes often insist that the only alternative is something more costly, like sending in ground forces. Were they right, drone strikes would be a bargain. But doing something nonmilitary, or doing nothing at all, is always an option.

Terrorism's limited threat to Americans bounds the benefits that targeted killings provide. The benefits often attributed to military counterterrorism programs—such as the absence of major attacks in the United States since 2001—rely on high baseline expectations for what terrorism might accomplish. In fact, the terrorist threat to Americans is tiny compared to even moderate health risks and far smaller than political rhetoric generally suggests. Globally, terrorists killed 13 Americans in 2013 and 32 in 2014, according to the National Consortium for the Study of Terrorism and Responses to Terrorism, or "START," database. Annual totals were not much higher in the late 1990s, casting doubt on the argument that the vast increase in U.S. counterterrorism efforts subsequent to the 9/11 attacks is what is keeping deaths low. More plausibly, credit should go mostly to relatively simple and relatively cheap measures, such as tracking terrorists through intelligence work, policing, and immigration controls at borders. As John Mueller writes in Chapter 66 on homeland

security, most counterterrorism programs at best make improbable dangers slightly less probable.

This take on the danger posed by terrorists remains controversial, and the prior paragraph alone is unlikely to change many minds. Skeptical readers should consult the suggested readings below. Still, all readers should at least agree that, if this take on terrorist capability is correct, then counterterrorism policies with uncertain and distant costs are probably not worthwhile.

Even the limited potential benefits of targeted killings are difficult to achieve. That's because killing terrorists is a tactic serving a counterterrorism strategy that is difficult to execute. That strategy, which I call disruption and decapitation, uses those two methods to suppress and ultimately destroy terrorist groups. "Disruption" undermines terrorists' ability to function and launch attacks by keeping members on the run, deterring recruits, and demoralizing members. "Decapitation" means killing a group's leaders to undermine its organization and morale. Strikes can aim at both goals. If the group is small enough, this strategy might morph into "elimination," such that strikes aim to kill off an organization entirely.

There are indications that the strategy succeeds in suppressing terrorism. Intelligence gleaned from killed or captured terrorists, including Osama bin Laden, suggests that the drones do cause terrorists to devote great efforts to self-preservation. At least according to some U.S. officials, al Qaeda's organization in Pakistan has been nearly eliminated. Off the record, the Obama administration gives that reason for slowing down drone strikes there. Only 3 have occurred in 2016 after a peak of 128 in 2010, by the Bureau of Investigative Journalism's count.

Still, there is reason to suspect that this strategy is insufficient to defeat terrorist organizations. Disruption and decapitation grow out of strategic airpower theory, which holds that airstrikes aimed at the enemy's industry and political leadership can achieve victory in a conventional war, independent of armies. That theory has a remarkably poor track record. Historical studies, like the Strategic Bombing Survey undertaken by the U.S. government after World War II, show that strategic airstrikes tend to do less harm than planned and to trigger people's sense of national solidarity, heightening leaders' support without much dampening their ability and desire to fight.

Studies of decapitation as a counterterrorism tool largely follow the same critique. With some important exceptions, the literature takes a skeptical view, contending that decapitation is effective only in narrow

circumstances, such as when targeted groups are young, small, and unpopular. That description poorly fits current terrorist adversaries, with certain exceptions, such as the ISIS affiliate in Libya. Some studies suggest that successful decapitation may fragment terrorist organizations into pieces that are even more dangerous. A simpler reason to doubt that disruption and decapitation work is that U.S. drone strikes continue in each nation where they have occurred. The enemy may be disrupted, but it evidently persists.

Hidden Costs of Targeted Killings

One reason that policymakers are inclined to support targeted killings in spite of these difficulties is that the direct costs are low. Budgetary costs—including some portion of war and intelligence budgets, plus much of Special Operations Command and the cost of buying and operating armed drones—are probably less than $20 billion annually, which is just 3 percent of U.S. military spending. Moreover, the annual number of U.S. personnel killed in service of these missions is generally either a handful or none. These seemingly low costs encourage a "why not?" approach toward targeted killings.

The problem is that the strikes may have far higher costs than is initially evident. Because those dangers are nebulous and slow to arrive, policymakers focused on the short term will tend to overlook them. One such risk is blowback, which occurs when airstrikes or raids anger people in targeted nations in ways that cause them to retaliate. Individuals might become terrorists themselves or support the targeted organization, meaning that strikes generate ever more terrorists to hunt. Blowback might create support for anti-American insurgents or foreign leaders' disinclination to cooperate with U.S. requests.

Proponents of drones argue that they create little blowback because their surveillance and precision targeting capability allows discriminate strikes. As the Stimson Center's Task Force on Drone Policy recently noted, drones generally produce fewer civilian casualties than weapons systems that would be used in their stead. However, the scholar James Igoe Walsh points out that drone strikes are typically used in remote, dangerous regions where reliable targeting intelligence is tough to get and verify. Strikes relying on shaky intelligence inevitably strike the wrong target on occasion, as in 2015 when a CIA strike in Pakistan killed an Italian and an American hostage. So although drones likely produce less blowback than alternative military means that might be used in their

stead, they may produce a considerable amount compared with not striking at all.

Another risk of targeted killings, especially drone strikes, is their potential to serve as a slippery slope to wider or continual war. Drone strikes make wars easier to start but not necessarily easier to win. Terrorism tends to occur amid insurgencies driven by political disagreements that drone strikes do not settle. Even strikes that succeed in suppressing terrorism may seem to fail as the conflict persists and the terrorist group continues to function. That perceived failure might also encourage a president, especially one facing domestic criticism for failing to eradicate a terrorist organization, to escalate the war.

Another slippery slope scenario arises if targeted killings create new enemies. By targeting Islamist insurgents—due to fear that they are either planning attacks on the United States or helping groups that are—strikes might turn insurgents focused on local enemies into terrorists working to kill Americans. Strikes, in other words, might produce what they are intended to combat. Because the terrorists that the United States targets in Pakistan, Yemen, and Somalia are enmeshed in broader Islamist insurgencies, it is likely that this scenario has already occurred to some extent.

Recommendations

These potential costs, along with the limited benefits of counterterrorism and the difficulties of executing a counterterrorism strategy of disruption and decapitation, justify skepticism about the value of targeted killings. The United States should vastly reduce drone strikes and special operations raids outside broader war zones and rely on either more indirect methods of counterterrorism (such as military assistance for local forces) or nonmilitary methods (such as intelligence cooperation). These alternative approaches are not silver bullets, but they carry far less risk of blowback and a slippery slope to broader war.

Congress should heighten oversight of targeted killings. That might require statutory reform to ensure that Joint Special Operation Command's lethal actions outside traditional war zones are reported to the armed services committees. Congress should consider suspending targeted killing in Pakistan, Yemen, and Somalia, at least until the executive branch provides studies or public testimony explaining why the policy makes sense in each nation. At that point, Congress should debate the matter and vote on whether to authorize strikes. Authorization should be limited

to a particular state or region and expire after a time period or under certain conditions.

If the next president or Congress will not stop, drastically reduce, or provisionally suspend drone strikes outside war zones, they should at least require the military, CIA, or a congressional panel to publish studies of the benefits and risks of current military counterterrorism efforts, especially drone strikes. Although any studies' judgments would be uncertain, the exercise might at least produce debate conducive to insight.

In general, U.S. security policy should reflect greater wariness of methods said to achieve ends historically delivered by war while avoiding its traditional costs. Whether the agent is drones, special operations forces, cyberattacks, or bomber aircraft, policymakers should keep in mind the old saying that you can't get something for nothing. The full cost might be hidden, with the bill coming. Or the good might do less than promised. If it costs so little, it probably isn't worth too much.

Suggested Readings

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—Prepared by Benjamin H. Friedman

68. The Military Budget

Policymakers should

- adopt a grand strategy of restraint to guide military budget reductions;
- reduce the end strength of the U.S. Army, Marine Corps, and Special Operations Command;
- focus the Navy on warfighting rather than on presence patrols, and reduce the fleet size accordingly;
- cut roughly a third of Air Force air wings and the land-based intercontinental ballistic missiles and bomber legs of the nuclear triad;
- reduce personnel, operations, maintenance, intelligence, and administrative spending to meet these force structure reductions;
- shrink excess base capacity and reform military compensation and benefits; and
- retain military spending caps, adjust them to include war spending, and extend them past 2025.

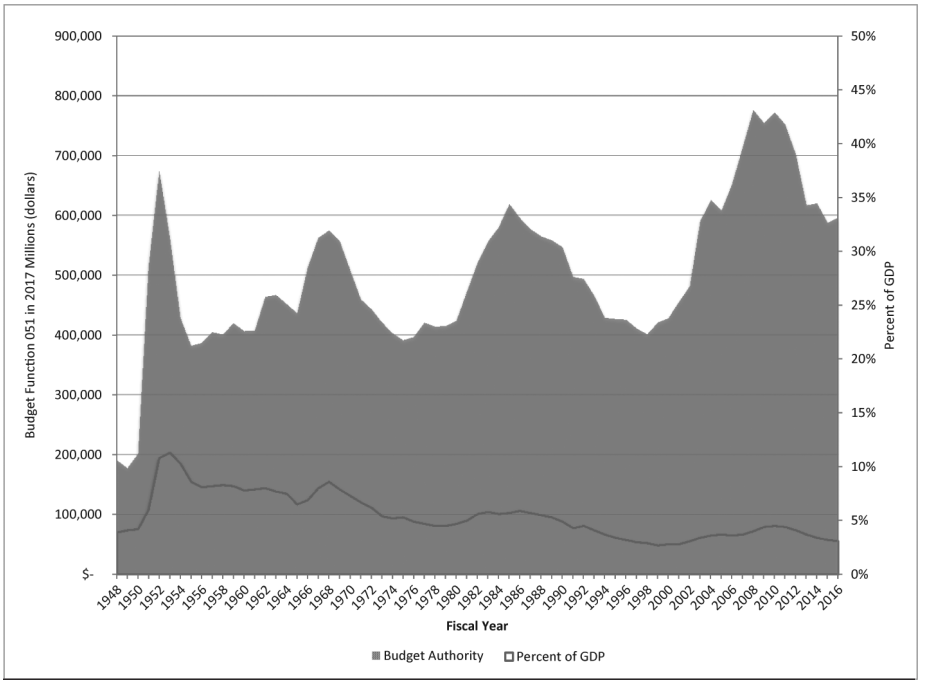
The United States will spend $607 billion on "national defense" in 2016, according to the government's definition. That includes $522 billion for the nonwar, or base, Pentagon budget; $59 billion in the Overseas Contingency Operations (OCO) budget, ostensibly for wars; and $26 billion for defense-related activities in other agencies, principally the Department of Energy's spending on nuclear weapons. That total, hereafter referred to as the military budget (as it is not particularly defensive), is 36 percent higher in real terms than in 2000, with two-thirds of the growth in nonwar spending. That is more, in inflation-adjusted terms, than annual military spending during the Cold War, except for the brief

peaks during the Korean War and the 1980s. It is more than double what Russia, China, Iran, and North Korea collectively spend on their militaries. And that amount excludes an additional $290 billion in U.S. security-related spending, which funds the budgets of Veterans Affairs, Homeland Security, and the State Department.

Still, according to the officials in the Pentagon, White House, and Congress who manage the military budget, that amount is too small, a victim of cuts required to meet the annual "sequestration caps" imposed by the 2011 Budget Control Act, in the name of deficit reduction. They argue that the caps, in place through 2021, are overly austere and threaten to leave the U.S. military underfunded and unable to meet mounting dangers. The caps remain only because of partisan disagreement over how to end them without increasing federal debt.

This chapter takes the opposite view. It argues for lowering the caps and cutting the military budget because it does not defend against national

Figure 68.1
Historical U.S. Military Spending



SOURCE: U.S. Department of Defense, "National Defense Budget Estimates for 2017 (Greenbook)," March 2016: http://comptroller.defense.gov/portals/45/Documents/defbudget/fy2017_Green_Book.pdf.

security threats so much as pursue a strategy of primacy, which amounts to trying to dominate global politics with the U.S. military. The chapter then considers alternative ways of cutting the military budget and makes the case for using the grand strategy of restraint to guide cuts. Finally, the chapter discusses specific areas of the budget to cut, as recommended under restraint.

Why the Military Budget Should Be Cut

Before turning to the main argument—cutting the military budget—two common objections are worth addressing. One says that because the budget is economically sustainable, it should not cause concern. It is 3.5 percent of gross domestic product (GDP) and 20 percent of federal spending, which is far less than entitlement spending. Those looking to reduce deficits should find fatter targets, so the argument goes.

It is true that the U.S. military budget is economically sustainable. Thanks to economic growth, that 3.5 percent of GDP buys about what 13 percent of GDP did in the early 1950s. We could spend far more without economic calamity. But there is a difference between what is possible and what is wise. The United States is rich enough to do all sorts of foolish things, at least for a long time. Even so, resources remain limited, and spending frivolously takes funds from better uses. The view that defense should be spared the axe because entitlements cost more assumes either that excess can only be confronted one place at a time or that heavy spending in one place justifies waste elsewhere.

A second objection to cuts, periodically expressed by Pentagon leaders, is that the military budget has already taken its cuts thanks to the "sequestration" imposed over the last several years. That argument is misleading on two counts. First, although the 2011 Budget Control Act did impose austerity on the Pentagon via spending caps in place through fiscal year 2021, the equal, across-the-board cuts known as sequestration occurred automatically only in 2013. In each subsequent year, sequestration would have occurred only to enforce the caps if Pentagon spending exceeded them. Second, the planned cuts never quite arrived. Compliance with the original caps would have cut base spending 14 percent by 2021—hardly draconian after a decade in which it grew 40 percent. The budget deals reduced that cut from 14 percent to 10 percent, according to Congressional Research Service estimates. War funds further reduced austerity's bite. Because OCO is exempt from the caps once Congress and the president declare an "emergency," it can be used to transfer uncapped money to

cover the Pentagon's nonwar needs. Congress can technically comply with the cap, avoiding sequestration, while handing the Pentagon its money back under the table through OCO. According to a recent Stimson Center report, nearly half of the OCO budget now properly belongs in the base.

Those attenuated caps did force some adjustments to Pentagon plans. Active-duty Army end-strength dropped from 570,000 to 475,000 troops over the last five years and is due to hit 450,000 in 2018 (980,000 including the National Guard and Reserves). The Navy and Air Force saw delays in the procurement of new aircraft and ships and some orders trimmed. Some administrative units shrank, and Congress finally agreed to some modest efforts to curtail pay raises and health care and housing benefits.

Still, the Pentagon dodged the hard choices that a real drawdown would have required. No cancellation of a major procurement program has occurred since 2011. More important, the Pentagon essentially avoided strategic adjustment. The much-ballyhooed rebalancing (or "pivot") to Asia produced no rebalancing of funds to the Navy and Air Force, which are most relevant to China. U.S. leaders renewed troop commitments to Europe and the Middle East. The only big change that has a strategic rationale is the Army's shrinkage.

The insufficiency of the recent cuts is evident in the Pentagon's latest five-year spending plan. According to the Congressional Budget Office (CBO), the plan would exceed the caps by $107 billion between 2017 and 2020. Moreover, as CBO notes, less rosy assumptions about cost control and adoption of measures Congress heartily opposes (e.g., another round of Base Realignment and Closures) add another $57 billion to that excess by 2020. Congress is likely to raise budget caps again, but not enough to cover the difference. Nor is the expiration of the current caps in 2021 likely to end the search for military savings. CBO expects federal spending to raise the deficit from 2.9 to 4.9 percent of GDP over 10 years, while adding nearly $10 trillion in debt. Recent experience suggests that this debt will sustain the push for deficit controls. Republicans will likely block tax increases, Democrats will protect entitlements, and deficit-reduction efforts will focus on discretionary spending, more than half of which belongs to the Pentagon.

The primary reason that the Pentagon budget should be cut is that it is far bigger than threats to U.S. security require. Three points are worth noting here. First, U.S. wealth, technical prowess, and geography generate enviable security before the Pentagon spends a cent. The dangers that states create militaries to combat—invasion and civil war—are unthinkable here.

Second, little of the U.S. military budget is related to fighting the terrorist groups that draw so much military attention. Those costs are mostly contained within the $59 billion OCO budget. A more generous count that includes the budget for special operations and a portion of the intelligence budget still falls well short of $100 billion, or a sixth of the total budget. Even a more expansive war against the Islamic State and the various remaining al Qaeda affiliates would not require added military capability or spending in the base (nonwar) Pentagon budget—unless, that is, the United States launches another manpower-intensive counterinsurgency operation in a foreign state or two.

Third, the nations that threaten the United States are historically few and weak. North Korea remains a blustery troublemaker with a tiny nuclear arsenal and a ballistic missile arsenal of decent range. But poverty has atrophied its military capabilities to the point that its internal collapse is a bigger threat than its aggression. Iran has the money to fund extremists like Hezbollah and to antagonize its neighbors. But its military lacks the expeditionary capability to pose much direct threat to its neighbors, let alone U.S. forces, unless they are occupying Iran. The recent nuclear deal does not much affect that military balance. Russia is considerably more capable and a threat to its weak neighbors, especially Ukraine. But with an energy-dependent economy now about the size of Italy's, the Kremlin has little ability to challenge nations further west, whatever its ambitions.

Of course, in the longer term the most capable challenger to the U.S. military is China. Should it sustain its rapid growth, which is doubtful, and continue its recent rate of investment in its naval and air forces, it could become the dominant military power in East Asia and even rival the United States in some respects. That might encourage Beijing to more forcefully assert its contested claims in the East and South China Seas, heightening tensions with the United States, insofar as it backs China's local rivals. Several recent think tank studies suggest that improved Chinese surveillance and missile capability will soon threaten U.S. aircraft and ships, especially aircraft carriers, at greater distance. That capability, it is feared, will deter U.S. forces from defending allies or will embolden the Chinese to see things that way and risk aggression.

That argument should not preclude a drawdown for several reasons. One is that it overlooks countermeasures that U.S. ships can take to defend themselves. If need be, U.S. military spending can be redirected to address the problem, rather than increased overall. Two, China's ability to conquer U.S. allies will remain limited, given the inherent advantages held by those

defending their own shores and their ability to adopt the same technologies abetting Chinese defensive improvements. Three, the argument overstates the difficulty of deterrence. It implies that only invulnerable forces can deter aggression, which would have surprised the Cold War architects of U.S. defenses in Germany. And it casts China's generally pragmatic leaders as zealots willing to risk economic dislocation and nuclear war for nationalistic adventures.

How to Cut Military Spending

The real reason U.S. military spending is so high is not the threats it meets but the ambitions it serves. The primacy strategy of global military dominance, which Chapter 65 discusses, fails to guide choices among military responses to danger. Because primacy sees threats and prescribes forces almost everywhere, it offers little basis for budgetary limits or prioritization. In that sense, it is less a strategy than a justification for expansive military ambitions. At a minimum, it endorses the present size of the U.S. military, with units permanently deployed in Europe, East Asia, and the Middle East, various training missions, and global naval patrols.

A strategy of restraint, by contrast, would husband U.S. power and focus planning on actual threats. By keeping U.S. forces out of avoidable troubles, restraint would reduce the number of wars the Pentagon must plan to fight, allowing big reductions in military spending. A less busy military could be a smaller and cheaper one.

Cuts guided by restraint would save far more than those offered by the most popular method of reducing spending, which is to target "waste, fraud, and abuse." The latter approach objects less to U.S. military ambitions than to the Pentagon's inefficiency in pursuing them. It recommends savings via managerial reforms—acquisition reforms, improved financial management, and empowering civilian technocrats to eliminate programs that seem redundant.

The problem with that approach is that the spending it targets is a chimera. Everyone opposes "waste." But attempts to find it reveal that nearly every military program does something and creates a political constituency who swear that the nation's security requires its full funding. The Pentagon surely spends too much buying weapons, but the trouble is rarely sneaky contractors or rules that fail to control them, so much as satisfying those who rule over acquisitions: military leaders load in requirements to serve their service's goals, and members of congressional defense committees defend the contracts that employ a chunk of their

constituents. Achieving real Pentagon savings requires having fewer goals and taking on the special interests dependent on the associated spending.

A second alternative approach to cuts is the "Nike" way, in which you "just do it," lowering the total and letting the Pentagon sort out the details. That is essentially the approach that the White House and congressional leadership inadvertently selected by agreeing to spending caps while asking the Pentagon to do everything it had been doing. One virtue of legislated future caps is that they lock in future Congresses. The difficulty of overcoming the status quo protects the cuts. This method also has the advantage of being the most doable; it is easier to agree on cutting spending than on a strategic rationale for doing so.

In theory, budgetary restraint can drive efficiency and strategic restraint. Heightened resource constraints encourage service leaders to squeeze overhead costs more than instructions to find fat. Spending constraints also require more prioritization among goals, which is the essence of strategic planning. Particularly when interservice competition occurs, budgetary pressure can cause the services to debate priorities and offer alternatives to policymakers looking to limit objectives and save money. The Navy, for example, in promoting offshore methods of meeting threats, might highlight the risks of deploying U.S. ground forces to confront them and note the advantages of carrier-based airpower over land-based fighters.

The strategic and Nike methods of cutting the budget could be fruitfully combined. Restraint, in the sense of having fewer allies and wars, is possible without budget cuts; but in the absence of fiscal pressure to adjust, restraint would likely be little more than a slogan used by those doing the same old things. By articulating a strategy of restraint, imposing lower caps, and encouraging interservice competition, leaders could get the best of both approaches.

Suggested Cuts

Restraint-oriented reforms would arrive gradually as the United States exited alliances, ended wars, closed facilities, and retired forces. They would be achieved by reducing commitments and military units. Divesting force structure would allow further savings in personnel, operations and maintenance, intelligence, and real estate costs. The following cuts, once realized, would cut roughly 25 percent from current projections.

Restraint would take advantage of America's geographic position and give the Navy a larger share of the Pentagon's reduced budget. The Navy would shrink, but less than other services. Ships and submarines have

Suggested Cuts

Ground Forces

- Reduce active-duty Army end-strength to 360,000 or fewer soldiers.
- Reduce active Marine Corps end-strength to 145,000 or fewer.
- Cap the Army Reserves at 165,000 soldiers.
- Reduce the Army National Guard to 290,000 soldiers.
- Reduce the Special Operations Command to 40,000.
- Reduce operations and personnel costs to match reductions in ground combat units.

Navy and Air Force

- Reduce the number of carriers and associated air groups to eight.
- Retire at least three amphibious assault ships.
- Cease production of the littoral combat ship.
- End the F-35 program and buy less advanced fighter aircraft instead.
- Accelerate the shrinkage of the attack submarine force.
- Reduce the Air Force's tactical aircraft fleet (including those in the National Guard) by at least a third.
- Reduce operations and personnel costs to match reduced force size.

Nuclear Weapons

- Limit bombers and fighter aircraft to conventional (nonnuclear) missions.
- Retire intercontinental ballistic missiles.
- Cancel the new nuclear-armed cruise missile.
- Cancel upgrades to the B-61 gravity bomb.

Administration

- Consolidate or close geographic combatant commands and overseas bases.
- Reduce three- and four-star commands.
- Reduce associated contracting and civilian personnel.
- Reform maintenance and supply systems.
- Cut spending on intelligence and missile defense.
- Adopt more cost-controlling reforms for military compensation.
- Authorize another Base Realignment and Closure round at home and for foreign bases.
- Cut most Overseas Contingency Operations funding; leave only what is actually necessary to conduct the air campaign against the Islamic State.

access to most of the earth's surface without the need for basing rights. With gains in range and massive increases in missile and bomb accuracy, carrier-based aircraft can deliver firepower to most targets, even in those states with considerable ability to defend their coastlines. The Navy would

operate as a surge force that deploys to attack shorelines or open sea lanes, rather than pointlessly patrolling peaceful areas. Divested of presence-driven requirements, the Navy could reduce the number of carriers and associated air groups it operates to eight, retire at least three amphibious assault ships, cease production of the littoral combat ship, replace the floundering F-35 program with F/A-18s, and accelerate the shrinkage of the attack submarine force. These cuts would allow additional reductions in operations and personnel costs to match the reduced fleet size.

Restraint recommends cuts to ground forces for two reasons. One is the dearth of conventional wars in which the United States might play a leading role. In the event of a conventional war on the Korean peninsula, in the Persian Gulf region, or even in Eastern Europe, wealthy U.S. allies should man the front lines. No modern Wehrmacht is poised to overcome them. The other reason is that counterterrorism is poorly served by manpower-intensive occupational wars, which rarely produce stability, let alone democracy.

U.S. policymakers should cut the active-duty Army to 360,000 or fewer soldiers, as opposed to the current plan of 450,000, and reduce the Marine Corps' end-strength size to 145,000 rather than 182,000. Because restraint requires less frequent deployments and reduces the emphasis on deployment speed, cuts to Reserve and National Guard forces would be proportionally smaller—the Reserves would be capped at 165,000 rather than 195,000 and the National Guard would shrink to 290,000 rather than 342,000. Reduced demand for military-to-military training and fewer wars would allow Special Operations Command to cut its current size of 63,000 down to 40,000.

Restraint also recommends cutting the Air Force's air wings across active and reserve forces. Few enemies today challenge U.S. air superiority, which is why so many missions go to drones and nonstealthy aircraft with limited ability to fend off rival aircraft or surface-to-air missiles. Recent advances in aircrafts' ability to communicate, monitor targets, and precisely strike them with laser guidance and Global Positioning Systems have made each aircraft and sortie vastly more capable of destroying targets. Naval aviation, which also benefits from these gains, can bear most of the airpower load. The Air Force's tactical aircraft fleet, including those in the National Guard, should be reduced by at least a third, allowing similar reductions in support units.

Additional reductions to the Air Force budget could come from reducing its nuclear weapons spending. A credible nuclear deterrent does not require

1,900 nuclear weapons deployed on a triad of delivery vehicles—bombers, land-based intercontinental ballistic missiles, and submarine-launched ballistic missiles. The new nuclear-armed cruise missile should be cut, and upgrades to the B-61 gravity bomb should be canceled. Shifting to a submarine-based monad could yield far larger savings. Even if extended deterrence—protecting allies from aggression—requires the ability to preempt enemy nuclear forces, which is doubtful, a submarine-launched ballistic missile force could achieve that goal. Thanks to accuracy gains, conventional cruise missiles could help by destroying hardened silos and threatening enemy arsenals. It is often said that the triad is necessary to ensure that U.S. nuclear forces survive preemptive attacks and thus to deter those attacks. But no enemy can reliably track U.S. ballistic missile submarines, let alone do so with the sort of reliability required to attempt a preemptive strike against all of them. Changes in that circumstance would be detectable in time to restore another leg, and air-launched cruise missiles could be stored as a hedge.

The cuts to force structure listed above would allow additional reductions to the Pentagon's administrative costs. Additional savings could come from consolidating combatant commands, reducing three- and four-star commands, reducing associated contracting and civilian personnel, and reforming maintenance and supply systems. Spending on intelligence and missile defense could also be reduced substantially.

Independent of strategy, compensation costs—including basic pay, medical costs, housing allowances, and other benefits—need controlling. The cost of enlisted service members has virtually doubled since 2000, with compensation far exceeding comparable private-sector earnings. Service leaders and a bipartisan coterie of defense experts annually beg Congress to adopt cost-controlling reforms. Congress should accept more aggressive cost-saving proposals in these areas.

Congress should also cut down on the Pentagon's real estate spending, starting with another Base Realignment and Closure round. The Pentagon estimates that base capacity exceeds its needs by 20 percent and that the five rounds between 1988 and 2005 produced $12 billion in recurring annual savings. Additional cuts could target the Pentagon's spending on overseas base infrastructure as the United States reduces commitments abroad.

A rough estimate is that those cuts would reduce nonwar military spending by about 20 percent, to about $435 billion. Because the United States would fight fewer wars under a policy of restraint, it could also get

rid of most OCO funding, leaving only the funds actually necessary to prosecute the air campaign against the Islamic State. Generously, we can call that $20 billion, resulting in another $39 billion in annual savings compared with present spending. That yields a new military budget of $455 billion, which is 25 percent lower than the present one.

If some U.S. wars and strikes continue in Afghanistan, Pakistan, Syria, Iraq, Libya, Yemen, and Somalia, we should abandon the pretense that they are an unforeseen emergency. OCO should be folded into the base Pentagon budget, as occurred in some past wars. War spending should be included under an adjusted defense spending cap, still enforced by sequestration, which should be extended to 2025 at least.

Keeping war spending uncapped encourages Congress, with the executive branch's contrivance, to stash base defense money in OCO, a habit that reduces the need for overdue reforms in the Pentagon. The current arrangement also arguably gives Pentagon leaders incentive to support wars: it lets them reap OCO's largesse. Moreover, leaving OCO spending uncapped makes its costs seem less than they are. Because distance, low costs, and safety already make U.S. wars seem nearly costless to most citizens, the wars commence with too little thought and debate. By requiring war to be paid for now, caps would make clear the tradeoffs between war and other priorities. That would spark some congressional debate as to the worth of those conflicts and slightly combat the tendency to wage war frivolously.

Proponents of current military spending argue that a restrained military budget is a radical notion that will expose Americans to danger. But what is truly radical is the idea that U.S. security requires securing rich states in perpetuity, maintaining military interventions in several poor ones simultaneously, patrolling the seas endlessly, and spending the better part of a trillion dollars a year to those ends. Given the safety the United States can enjoy if it avoids looking for conflicts to manage, the proposals here are actually cautious. They would not only save a fortune but also might even keep U.S. forces out of avoidable trouble.

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—Prepared by Benjamin H. Friedman

69. Iran

Policymakers should

- realize that the Iranian nuclear accord, while imperfect, imposes significant restrictions on Iran's ability to develop a nuclear weapon;
- focus on ensuring the implementation of the deal's key provisions;
- understand that a strategy of pressure is unlikely to dissuade Iran from supporting militant Shiite organizations throughout the Middle East and will likely strengthen hard-liners in Iran; and
- seek sustained engagement with Iran instead, fostering trust and seeking compromise solutions to ongoing crises in the Middle East.

The Nuclear Deal

For the past several years, negotiation of the Iranian nuclear deal—technically the Joint Comprehensive Plan of Action (JCPOA)—has dominated U.S.-Iranian relations. The JCPOA has proved to be extremely divisive inside the United States. The Obama administration and others championed the agreement as a landmark accord, while critics have argued that it is fundamentally flawed and may permit Iran to become a threshold nuclear power. Many have insisted that the next president should either tear up or renegotiate the agreement. Yet for all its flaws, the JCPOA offers not only the best chance to prevent a nuclear Iran, but an opportunity for engagement that can build trust, improve U.S.-Iranian relations, and reduce the likelihood of destabilizing actions by Iran in the future.

There is no denying that the deal is imperfect in a number of respects. Although it limits Iran's capacity to enrich uranium, the agreement permits continuing research and development of gas centrifuge enrichment technology. That provision is particularly troublesome because the physical constraints on Iranian fissile material production (as well as a number of verification provisions) expire in 10–15 years. Conceivably, then, Iran could continue conducting research on uranium enrichment over the next decade and subsequently go nuclear in fairly short order as the JCPOA restrictions expire.

Yet such concerns should not prompt U.S. policymakers to either abrogate or attempt to renegotiate the JCPOA. The agreement places significant restrictions on Iran's ability to develop a nuclear weapon. Withdrawing from the agreement would be particularly counterproductive. If the United States were to tear up the JCPOA and reimpose sanctions, Iran would no longer be bound by the agreement. And the United States' principal allies would likely refuse to follow the U.S. lead in renewing sanctions. By renouncing the JCPOA, the United States would consequently forfeit strict limits on Iran's nuclear program, including one of the most intrusive and thoroughgoing inspection and verification regimes on record, in exchange for ineffectual unilateral sanctions.

Even attempting to renegotiate the JCPOA would be unwise. Neither Iran nor America's European allies would have much (if any) incentive for doing so. Moreover, attempting to reopen negotiations would undermine Iran's confidence in the United States as a negotiating partner. If Tehran concluded that Washington could not be trusted to accept and abide by settled agreements, Iranian officials would be even less likely to seek solutions to outstanding issues of mutual concern—such as the ongoing civil war in Syria.

Instead, U.S. policymakers should focus on ensuring the implementation of the JCPOA and eventual negotiation of an extension of its restrictions on fissile material production. That provision is the primary weakness of the JCPOA: it permits Iran to increase uranium enrichment using more advanced centrifuges as the agreement's provisions expire, reducing breakout time. Yet even after the agreement expires, Iran will still be subject to monitoring and verification under the Nuclear Non-Proliferation Treaty. As an arms control agreement, the JCPOA has been successful. By fulfilling their respective obligations under the agreement, the United States and Iran can potentially begin to build mutual confidence and chip away at the mistrust that has built up over the past 35 years. That

confidence can serve as the foundation for future cooperation on many issues.

The Drawbacks of a Policy of Pressure

In addition to assuming responsibility for the JCPOA, the next U.S. administration will also need to decide how to address Iranian actions throughout the Middle East. Iran continues to pursue policies that American policymakers consider damaging to U.S. interests. Tehran's support for Shiite factions throughout the Middle East is undoubtedly a source of instability in the region. And there is little sign that such support is abating. Iranian support for the Houthi rebels in Yemen may have been substantially exaggerated, but Iran remains heavily involved in Syria, Lebanon, and elsewhere. Perhaps most worryingly, Tehran continues to espouse the destruction of Israel and supports both Hezbollah and Hamas, two groups that the United States has designated as terrorist organizations.

Some in Washington would counter those provocations by getting tough with Tehran. As they point out, the JCPOA does not prohibit the United States from imposing new sanctions in response to other Iranian policies—most notably, the sponsorship of international terrorism. In addition to the imposition of new punitive sanctions, some have even argued that the United States should launch a political warfare campaign to undermine the ruling Iranian theocracy, noting that the United States could sow disenchantment among the Iranian people and political establishment by inundating Iran with television, radio, and social media broadcasts highlighting the perverse consequences of the policies the Iranian regime has pursued since the 1979 revolution.

However, there is little reason to believe that pressuring Iran in this manner would advance American interests. First and foremost, new sanctions would be unlikely to dissuade Tehran from supporting militant groups. After all, the United States has had unilateral sanctions on Iran for decades; they have not tempered Iran's support for Hamas or Hezbollah. Iran's willingness to negotiate on the nuclear issue owes much to the overwhelming multilateral comprehensive sanctions regime, which crucially cut Iran's oil exports by approximately 50 percent. Now that the United States' principal European allies have already begun to strike new trade deals with Iran, it is highly unlikely that the United States would be able to drum up much international support for new punitive trade restrictions.

Moreover, Iran would almost certainly interpret new economic sanctions as evidence of American bad faith. Tehran has already expressed frustration that continuing U.S. sanctions for human rights abuses and terrorism, which were not addressed by the JCPOA, have prevented Iran from reaping as much new investment as they anticipated. Many multinational corporations and banks are wary of conducting business with Iranian entities, since transactions that pass through American banks or involve American citizens working for foreign companies technically remain subject to sanctions. Since the multinational banking company BNP Paribas was fined $9 billion in 2014 for sanctions evasion, foreign firms have been reluctant to engage in activities that might unintentionally violate secondary sanctions and subject them to U.S. punishment. By limiting the investment dividend that Iran is able to reap from the JCPOA, remaining U.S. sanctions may increase the clout of Iranian hard-liners (most of whom opposed the JCPOA) inside the Iranian government.

Imposing new sanctions or attempting to sow dissension within Iran would also, in all likelihood, militate against the United States' regional objectives. The United States will likely be unable to broker mutually acceptable resolutions to the conflicts in Syria, or to defeat the Islamic State, without Iranian cooperation. Securing that cooperation would be much more difficult if Washington imposed a series of new sanctions. Since Iranian leaders would surely interpret new sanctions as a violation of the spirit, if not the letter, of the JCPOA, they would grow even more skeptical that the United States can be trusted to abide by negotiated compromises.

Launching a political warfare campaign would be even more counterproductive, effectively confirming the suspicion espoused by Iranian hard-liners that the United States is intent upon catalyzing regime change in Iran. In all likelihood, hard-liners would respond by intensifying their suppression of domestic dissent and freezing more moderate officials out of government. By attempting to subvert the Iranian regime, the United States could thus undermine the very reformers it seeks to empower.

The Alternative: Cautious Engagement

Since getting tough with Iran is unlikely to yield positive results, the United States should instead pursue a policy of engagement. To begin, Washington should continue to uphold the JCPOA by striving to ensure that Iran benefits economically from the agreement. Perhaps the simplest way to do that is to issue clear guidance detailing how foreign firms can

invest in Iran without running afoul of remaining U.S. sanctions legislation. The United States should also attempt to build on the JCPOA by continuing to actively engage Tehran in negotiations over ongoing (and future) regional crises—most notably the wars in Syria and Yemen.

The idea of building diplomatic ties with Iran is no longer taboo. Indeed, an open letter to the president on the first anniversary of the JCPOA, advocating increased engagement between the two countries, was signed by 75 national security leaders from both parties, including 23 former ambassadors, 14 former members of Congress, and 3 Nobel laureates. And in the wake of the JCPOA, Iranian leaders are probably more disposed than at any point since 1979 to engage with the West. For instance, although Supreme Leader Ayatollah Khamenei issued a dictum in October 2015 asserting that further negotiations with the United States were forbidden, Iran accepted an invitation later that month to join the United States in multinational negotiations on Syria. The time is ripe to explore additional areas of common interest.

Negotiations are unlikely to yield immediate benefits. With Iranian and U.S. policymakers holding competing visions for the future of the Middle East—particularly concerning Syria, Lebanon, Yemen, and Israel—negotiating compromises that are acceptable to both countries will be exceedingly difficult. Yet, to the extent that negotiations eventually yield positive results, they can bolster more moderate Iranian officials, such as Prime Minister Hassan Rouhani, by demonstrating that Iran has more to gain through engagement than through confrontation. And by engaging in sustained negotiations on a number of different issues, Iranian and U.S. officials can gradually develop trust and mutual respect. The process of negotiations itself can lay the foundations upon which future compromises may be constructed.

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—Prepared by Emma Ashford and Bradford Stapleton

70. U.S. Policy toward Afghanistan

Policymakers should

- understand that escalating U.S. military involvement in Afghanistan is unlikely to decisively defeat the Taliban or its allies and may impede the creation of a durable and capable government there;
- realize that when the United States withdraws from Afghanistan, there is a risk that the Taliban or other organizations that we don't like could seize control of territory; and
- consider maintaining 5,000–10,000 U.S. troops in Afghanistan to train, advise, and assist Afghan forces but negotiate a timetable for the withdrawal of those troops by the end of 2020.

Since President Barack Obama announced the end of the United States' combat mission in Afghanistan at the close of 2014, U.S. troops in Afghanistan have assumed two, more limited, responsibilities: counterterrorism operations against al Qaeda and now the Islamic State–Khorasan Province (ISKP); and a mission to train, advise, and assist the Afghan National Defense and Security Forces. Although Obama had pledged to withdraw the United States' remaining troops by the end of his presidency, the resurgence of the Taliban prompted him to announce in October 2015 that at least 5,500 U.S. troops would remain in Afghanistan through 2016. By July 2016, he had decided to leave 8,400 troops in Afghanistan through the end of his presidency. In essence, Obama ceded responsibility for the ongoing Afghanistan challenge to his successor. Under the Trump administration, the United States will therefore have to choose among three broad options: (1) escalate U.S. involvement in the ongoing Afghan conflict, (2) maintain a small force of U.S. troops in a train-advise-and-assist role for some period, or (3) complete the military withdrawal that Obama halted.

Escalation

Some observers have suggested that, rather than withdrawing, the United States should reinforce Afghan forces. That could be accomplished in two different ways. The Pentagon could either deploy additional ground troops to resume combat operations in Afghanistan or ease restrictions that currently limit U.S. airstrikes in support of Afghan forces.

Deploying more U.S. troops to Afghanistan would be extremely unpopular. The announcement of the end of the United States' combat mission in Afghanistan in 2014 led most Americans to believe that our longest war would soon be at an end. Given that expectation, in conjunction with the bitter experience of the Iraq war, the resumption of combat operations would meet with considerable public resistance. Americans are understandably wary of seeing U.S. troops sucked into another foreign quagmire.

Moreover, it is doubtful whether another infusion of U.S. troops would do much good. After all, the troop surge that Obama launched in 2009 proved at best a temporary success. Though U.S. forces successfully suppressed the Taliban insurgency throughout much of southern Afghanistan, insurgents reasserted themselves following the U.S. withdrawal. There is no reason to expect that additional U.S. troops would now be able to impose a more durable peace. History shows that poor, ethnically fragmented societies recovering from foreign-imposed regime change typically struggle for years to establish peace and stability—and rarely institute sustainable democracy.

Rather than deploying more ground troops, policymakers might be tempted to expand U.S. airstrikes in support of Afghan forces instead. In addition to striking validated al Qaeda targets, U.S. air assets could target Taliban fighters—a practice that President Obama had for long stringently circumscribed. An escalation of airpower could seriously hamper the Taliban's ability to seize government-controlled territory and could prevent the Taliban from launching massed attacks against Afghan cities. But airstrikes are not a long-term solution. They would merely enable Afghan forces to keep the Taliban at bay for as long as the United States remains willing to provide air support.

Moreover, airstrikes cannot eliminate the root causes of terrorism. In fact, expanding the use of U.S. airpower in Afghanistan might actually undermine counterterrorism efforts by engendering greater anti-American resentment—within Afghanistan as well as in marginalized communities in the West. It is thus important to consider whether forestalling Taliban

expansion is worth the risk of fueling the recruitment of more anti-American terrorists.

Maintenance of a Residual Force

A strong case can be made for maintaining a residual force of 5,000–10,000 troops in Afghanistan. Although the United States could attempt to deny al Qaeda sanctuary in Afghanistan by prosecuting an ongoing drone campaign, maintaining a residual force in Afghanistan might help Afghan forces build the capacity to eventually keep the Taliban, ISKP, and al Qaeda at bay without continuing U.S. assistance. However, the continued presence of U.S. military advisers in Afghanistan might undermine confidence in the Afghan government, engender local resistance, or impede the move to self-sufficiency.

Over the past few years, in particular, Afghan government forces have struggled to suppress a resurgent Taliban. In 2015, the Taliban was able to concentrate large forces over more territory than at any time since 2001. Most ominously, in September 2015, Taliban fighters temporarily seized control of Kunduz, Afghanistan's fifth-largest city. Thus, it appears that Afghan forces are currently incapable of preventing the Taliban from reasserting its authority over at least some of the country. Although Afghan forces have gained tactical competency, a number of key capability shortfalls continue to undermine their overall effectiveness. Most notably, they lack the full range of airpower capabilities: mobility; resupply; aerial fire; and intelligence, surveillance, and reconnaissance. In addition, because they have relied on the United States for supplies for so long, Afghan forces have failed to gain competency in logistics and sustainment. By helping Afghan forces build capacity in those key areas, the United States can improve Afghan forces' ability to execute combined arms operations and hold territory that has been cleared of insurgent fighters.

Even with U.S. assistance, however, Afghan security forces are unlikely to be able to secure the country as long as Pakistan continues to provide sanctuary and support to Taliban fighters. Although Pakistan has conducted limited military offensives in its Federally Administered Tribal Areas (FATA), there is no indication that Islamabad is prepared to stop supporting Afghan insurgents. Pakistani officials remain fearful that Afghanistan might align with India, leaving Pakistan sandwiched between hostile states to the northwest and southeast. Given those fears, many Pakistani officials regard ongoing instability within Afghanistan as preferable to a strong, unified Afghani state. The United States and Pakistan

thus continue to work at cross-purposes in Afghanistan. By continuing to support the Taliban, Pakistan's military and Inter-Services Intelligence are likely to counterbalance the limited training and assistance that a small residual U.S. force is able to provide Afghanistan.

Given that reality, the repeated extension of the U.S. mission to train, advise, and assist risks establishing a de facto permanent commitment to Afghanistan. Since Afghan forces will in all likelihood remain incapable of decisively defeating the Taliban insurgency, reasons not to withdraw will inevitably present themselves to U.S. policymakers again and again. After all, the Taliban's resurgence convinced President Obama to abandon his withdrawal plan.

Withdrawal

Even though Afghan forces will likely remain incapable of securing their country, there are good reasons for U.S. forces to withdraw. Most important, there is essentially no significant al Qaeda threat emanating from Afghanistan. That is not to say al Qaeda has been defeated everywhere, but the threat the organization poses to the international community now comes primarily from outside Afghanistan. In the wake of the U.S.-led invasion, al Qaeda has sought refuge in Pakistan's FATA region. Meanwhile, numerous affiliated groups have sprung up throughout the greater Middle East, primarily in opposition to the so-called near enemy—apostate regimes in the Muslim world. Afghanistan is not a central front in the global war on terror.

The ongoing conflict in Afghanistan is essentially a civil war whose outcome is inconsequential to the United States. After all, the Taliban has been actively combating the emergence of ISKP, a group composed largely of disaffected former members of the Taliban. And the Taliban's focus is on imposing an extreme version of Shari'a law within Afghanistan, not striking foreign enemies abroad. The organization thus does not pose a direct threat to the United States.

The continuing resurgence of the Taliban could present an indirect threat to the United States, if the group were to permit al Qaeda to ensconce and revitalize itself in Taliban-controlled areas. That is already happening, to a degree; as U.S. troops have gradually withdrawn from Afghanistan, al Qaeda has moved back into territory beyond central government control. In late 2014, a Pakistani military offensive prompted al Qaeda militants to migrate from sanctuaries in North Waziristan into Afghanistan's Helmand and Kandahar provinces. In both southern and

eastern Afghanistan, al Qaeda is reconstituting the type of training camps that it operated with impunity prior to 2001. In October 2014, the United States discovered and then destroyed a training camp in southern Afghanistan, which military officials described as one of the largest they had ever encountered. Unfortunately, although the Taliban has actively (and quite successfully) fought the spread of ISKP, it has evinced much more willingness to tolerate and even support al Qaeda—perhaps because al Qaeda has shown little interest in contesting control of Afghanistan.

Although the U.S.-led coalition clearly degraded al Qaeda's operations in Afghanistan, there are signs that the organization is poised to reconstruct its support networks and infrastructure in the country. A phased withdrawal of U.S. troops will consequently entail a risk that the Taliban could regain control over parts of Afghanistan and could once again make the country a safe haven for anti-American terrorists.

The prospect of al Qaeda, ISKP, the Islamic State of Iraq and Syria (ISIS), or any other terrorist organizations establishing a safe haven in Afghanistan, however, does not warrant leaving a large U.S. force in Afghanistan indefinitely. The most effective counterterrorism operations of the past 15 years have not depended upon large numbers of troops stationed on foreign soil. U.S. efforts should focus on helping the Afghan government establish its authority by providing security for its people.

It therefore makes sense to resume withdrawing U.S. troops from Afghanistan. If U.S. policymakers choose to extend the U.S. commitment to Afghanistan past 2017, they should negotiate with Ashraf Ghani's government in Kabul to establish a clear timetable for the withdrawal of U.S. forces by 2020—an agreement that can be ratified by Congress. The virtue of such an agreement is that U.S. policymakers, by tying their hands, would inoculate themselves from the temptation to extend the U.S. commitment to Afghanistan in response to events on the battlefield—whether the situation has improved or not. Moreover, by signaling to Afghan forces that they will not be able to depend on U.S. advisers indefinitely, a timetable would provide a much-needed impetus to address key deficiencies in their forces. The United States could thus augment the ability of native Afghan forces to keep the Taliban at bay while finally extricating itself from Afghanistan.

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—Prepared by Christopher Preble and Brad Stapleton

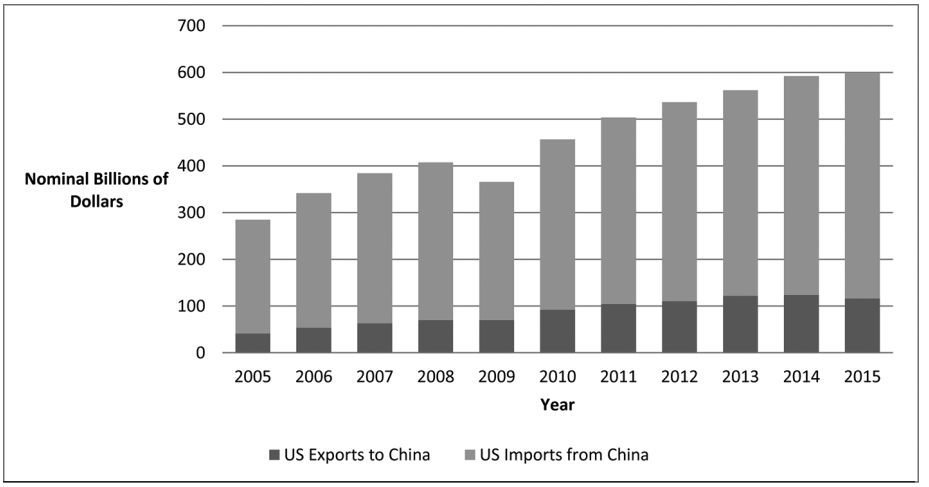
71. Relations with China

Policymakers should

- reject calls for protectionist economic policies, especially those that would negatively affect bilateral trade with China;
- move away from trying to preserve U.S. military primacy in East Asia and adopt a more restrained, modest strategy that does not seek to contain China;
- insist on maintaining freedom of navigation in the South China Sea while maintaining a policy of neutrality regarding territorial disputes;
- continue to sell weapons to Taiwan and provide economic support for the island, but end the implicit, increasingly risky defense commitment to the island;
- prevent competition in cyberspace from escalating into kinetic conflict; and
- clarify the U.S.–Japan defense treaty so that the United States does not have an obligation to defend the disputed Senkaku/Diaoyu islands against China.

The U.S.-China relationship features both cooperation and competition—though the latter has come to characterize the relationship to a much greater extent in the last year. With increasing regularity, Washington and Beijing have discovered where their interests diverge, since most of the "low-hanging fruits" of cooperation have already been exploited. Cooperation in the fields of environmental protection, reining in North Korea, and trade should be praised and encouraged. But sources of friction in the relationship, such as territorial disputes in the South China Sea and acts of Chinese cyber espionage against U.S. companies, require careful management by American policymakers.

Figure 71.1
U.S.-China Trade in Goods, 2005–2015



SOURCE: U.S. Census Bureau. https://www.census.gov/foreign-trade/balance/c5700.html

Policymakers in Washington must look beyond inflammatory rhetoric and calls for trade policies that would exacerbate the negative aspects of the U.S.-China relationship for little benefit. For example, according to the U.S. Census Bureau, total bilateral trade in goods for 2015 was valued at $599.3 billion: the United States exported $116.1 billion to China while importing $483.2 billion from China (see Figure 71.1). Disrupting this trade flow would be detrimental to both countries. Policymakers need to resist the growing populist calls for protectionist trade policies.

Given the scale and complexity of the U.S.-China relationship, a full accounting in this chapter is not feasible. Instead, this chapter will examine three major sources of friction in the relationship—territorial disputes with American allies, cyber espionage against U.S. companies, and America's grand strategy of primacy—and offer recommendations for U.S. policymakers to ease tensions. Figuring out ways to effectively manage these sources of friction will greatly benefit the U.S.-China relationship.

Territorial Disputes with U.S. Allies

The most serious source of friction in the U.S.-China relationship is territorial disputes between China and American allies. Beijing has made significant investments in its armed forces, acquiring advanced warships, missile systems, and aircraft and steadily improving the quality of military

training. According to the International Institute for Strategic Studies, China's official defense budget, which is widely considered to be lower than actual military spending, increased from $29.5 billion in 2005 to $146 billion in 2015. The dispute in the South China Sea has dominated recent headlines, but unresolved disputes between China and Japan in the East China Sea and a long-standing conflict between China and Taiwan could easily flare up in the near future.

Recently, the South China Sea has been the most active of the three conflict areas. Beijing's island-building campaign has added more than 3,200 acres of land to the seven "maritime features" that China occupies in the Spratly archipelago. Many of China's artificial islands include runways that can accommodate military aircraft, thereby threatening the security of other claimants, such as Vietnam and the Philippines, and vital international shipping lanes. In addition to island building, Beijing has made sweeping claims to the South China Sea that the United States considers to be in violation of international law. In response, the U.S. Navy has conducted "freedom of navigation operations" to protest the actions taken by China and other claimants that undermine international law and freedom of navigation. The United States has also extended military support to the Philippines, a treaty ally, and in May 2016 ended a long-standing arms embargo on Vietnam.

China has responded to these American moves with provocative policies that have only made the dispute worse and encouraged tougher American responses in turn. Examples of Chinese behavior include stationing antiship cruise missiles and fighter aircraft on Woody Island and using fishermen as "maritime militia" to harass other fishing boats. The most prominent attempt to peacefully resolve South China Sea issues was an arbitration case raised by the Philippines that challenged the legality of Chinese territorial claims. The case was heard by a tribunal at the international Permanent Court of Arbitration in The Hague. On July 12, 2016, the court's ruling declared China's claims to sovereignty and historic rights within its infamous "nine-dash line" (see Figure 71.2) to be unlawful, clarified the legal status of many land features within the Spratlys, and admonished China for the ecological damage caused by island building.

The court's ruling represents an opportunity for the United States and China to move away from the dangerous and counterproductive escalation of tensions that has dominated the South China Sea in recent years. As of this writing, Chinese officials have released fiery statements about the illegitimacy of the ruling, but China has not demonstrated any serious

Figure 71.2
China Territorial Claims in South China Sea

escalatory behavior. Policymakers in Washington should support openings for negotiations among the South China Sea claimants, resource-sharing agreements, or other opportunities for peaceful management of disputes in the wake of the arbitration court ruling. Beijing will not give up its core policy positions any time soon; but if short-term de-escalation is possible, the United States would be foolish to continue with policies that increase escalation risks. Above all, Washington must be careful not to create the impression that it might back the claims of China's rivals militarily. That is especially pertinent regarding the Philippines, given the bilateral defense treaty with that country. This does not mean that shows of military force or support for allies should be completely halted, but

rather used sparingly and as a component of a broader diplomatic strategy that emphasizes peaceful settlement of disputes.

The long-standing dispute between Taiwan and mainland China, which views the island as a part of its territory occupied by a rebellious government, does not carry the same kind of risk as the South China Sea dispute. Conflict between China and Taiwan, which would probably draw in the United States, is not as likely in the near term. However, America's implicit security commitment to Taiwan under the 1979 Taiwan Relations Act is a ticking time bomb. Growing Chinese military power poses significant challenges to U.S. military forces that would rescue Taiwan, and domestic political issues in Taiwan make reunification with China less and less likely.

Cross-strait relations have deteriorated since the landslide victory of Taiwan's independence-leaning Democratic Progressive Party in the January 2016 presidential and legislative elections. For example, in June 2016, Beijing announced that it had suspended a communication mechanism between the Taiwan Affairs Office and its Taiwanese counterpart, the Mainland Affairs Council, because of Taiwanese president Tsai Ing-wen's refusal to accept the idea of "one China." Most people in Taiwan, and especially younger generations, see themselves not as Chinese people living in Taiwan, but as Taiwanese people. Support for reunification with China is very low; a survey conducted in early 2016 by the Taiwanese Public Opinion Foundation found that 51.2 percent of respondents favored independence at some point in the future while only 14.9 percent preferred reunification with China.

U.S. policymakers should reconsider the wisdom of the implicit security commitment to Taiwan, and do so promptly. Impatience or miscalculation on the part of Beijing, rash action on the part of pro-independence Taiwanese, or a bad accident could trigger a crisis with devastating consequences for the United States. Although ideally it would be useful to keep Taiwan out of Beijing's clutches, the costs of maintaining the implicit security commitment now outweigh the benefits. Stepping down from the security commitment to Taiwan would not preclude Washington from selling weapons systems to Taiwan for defense against China and maintaining economic and political support for the island, and the United States should continue to do so.

China's struggle with Japan over control of the Senkaku/Diaoyu Islands in the East China Sea is the final territorial dispute straining the U.S.-China relationship. America's military alliance with Japan ought to be maintained, but Washington's insistence that the alliance covers the dis-

puted islands in the East China Sea puts the United States in a risky position. Tensions between Beijing and Tokyo have been rising over the dispute for several years. In an armed conflict between China and Japan over the Senkakus/Diaoyus, the United States would be expected to risk war with China over a few uninhabited rocks. That is an unwise risk for the United States.

Cyber Espionage against U.S. Companies

Well-publicized intrusions into U.S. government and commercial networks have made cyber espionage, especially as it relates to the theft of American intellectual property, a source of friction in U.S.-China relations. China's use of cyberspace for intelligence collection targeting the U.S. government, military, and intelligence agencies is to be expected. But the United States government considers the theft of intellectual property by Chinese agents for commercial or strategic gains to be unacceptable.

During his September 2015 visit to Washington, president Xi Jinping of China reached a cyber agreement with the United States. One of the key provisions of the agreement was a pledge that neither country would "conduct or knowingly support cyber-enabled theft of intellectual property, including trade secrets or other confidential business information, with the intent of providing competitive advantages to companies or commercial sectors."

Despite the agreement, skepticism persists regarding Beijing's intentions and willingness to rein in cyber espionage against U.S. companies. A June 2016 report by FireEye, a cyber security firm, suggests that while progress has been made in reducing Chinese cyber espionage, skepticism is still warranted. The report indicates that the number of Chinese cyber espionage activities against U.S. companies has decreased significantly, but the threat has become "more focused, calculated, and still successful in compromising corporate networks." Also, the September 2015 cyber agreement was just one of several factors, including U.S. government pressure and Xi's military reforms, that contributed to the shift to fewer but higher-quality cyber espionage operations.

Cyber espionage against U.S. companies will remain a sore spot in U.S.-Chinese relations for the foreseeable future. Policymakers in Washington should continue applying diplomatic pressure on Beijing, but they must not overhype the threat posed by cyber espionage for commercial gain. Likewise, Chinese activities in cyberspace that target U.S. military and intelligence capabilities should be guarded against but not overblown. The

task of successfully incorporating stolen information into the Chinese economy or military can be much more difficult than stealing the information. American policymakers should also eschew threats to respond to cyberattacks with kinetic force.

American Primacy

The United States has enjoyed an overwhelmingly dominant position in East Asia since the end of World War II, and U.S. officials seem determined to preserve that position of primacy. But enough changes have taken place since the end of the Cold War that such an approach is no longer the optimal strategy. Indeed, it soon may not even be a feasible strategy given the excessive costs and risks that it incurs. Public statements by American military and political leaders that U.S. actions are not intended to prevent China's rise have not allayed Beijing's fears of containment.

A different strategic approach—one that downplays the role of forward-deployed military forces and places more responsibility on U.S. allies and other significant regional actors for balancing against Chinese power—would reduce the risk of U.S.-China conflict. Instead of trying to preserve a fading primacy, policymakers in Washington should focus on sustaining a narrower list of crucial U.S. interests in East Asia. Preserving freedom of navigation should be a high priority, given America's naval and commercial interests. Promoting a regional balance of power that can serve as a check against Chinese aggression with minimal American input would preserve stability in East Asia while reducing the main sources of dangerous friction in U.S.-China relations.

Managing relations with a rising great power is never easy, and this is certainly true with China. History is replete with examples of incumbent hegemons and rising powers colliding militarily, and with tragic results. The rise of Germany at the beginning of the 20th century, culminating in the onset of World War I, is a sobering reminder of a worst-case outcome for U.S.-China relations. Policymakers in the next administration need to make some tough choices to protect America's interests while avoiding needless conflicts with China.

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—Prepared by Ted Galen Carpenter and Eric Gomez

72. Relations with Russia

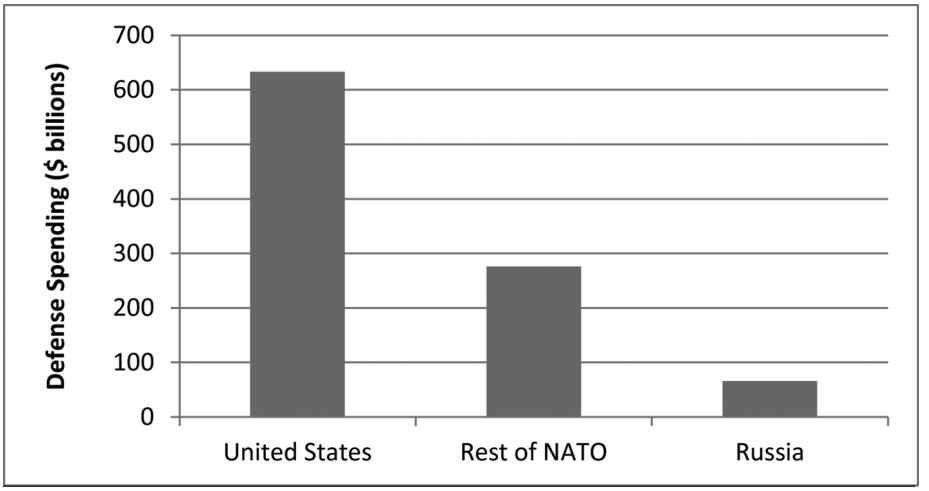
Policymakers should

- be concerned about the downward spiral in U.S.-Russian relations in recent years;
- understand that Russia's aggression in Eastern Europe is troubling but not a major threat to the United States;
- avoid taking steps that will increase tensions with Russia, such as arming Ukraine, substantially building up troops in Eastern Europe, or further expanding NATO;
- consider implementing sanctions aimed at impeding Russia's military modernization in place of current sanctions; and
- seek a constructive working relationship with Russia to address common diplomatic challenges, such as nonproliferation and ending the Syrian civil war.

The U.S.-Russian relationship has long been acrimonious. During the 1990s, with Russia seemingly poised to make a peaceful transition to democracy as a member of the European community, it appeared that the two countries might be able to escape the animosity of the Cold War. History took a different path, however, and recent years have arguably seen a more adversarial relationship than at any point since the collapse of the Soviet Union. Russia's 2014 annexation of Crimea and its involvement in eastern Ukraine's civil war resurrected its pariah-state status and resulted in heavy U.S. and European sanctions, while Russian intervention in Syria since 2015 has complicated the U.S.-led campaign against ISIS (the Islamic State of Iraq and Syria).

Russia itself poses limited military threat to the United States—primarily through its nuclear arsenal—and even its ability to threaten America's North Atlantic Treaty Organization (NATO) allies is often exaggerated. By some metrics, Russian military spending appears extremely high (5.4

Figure 72.1
Comparative Military Spending (2013)

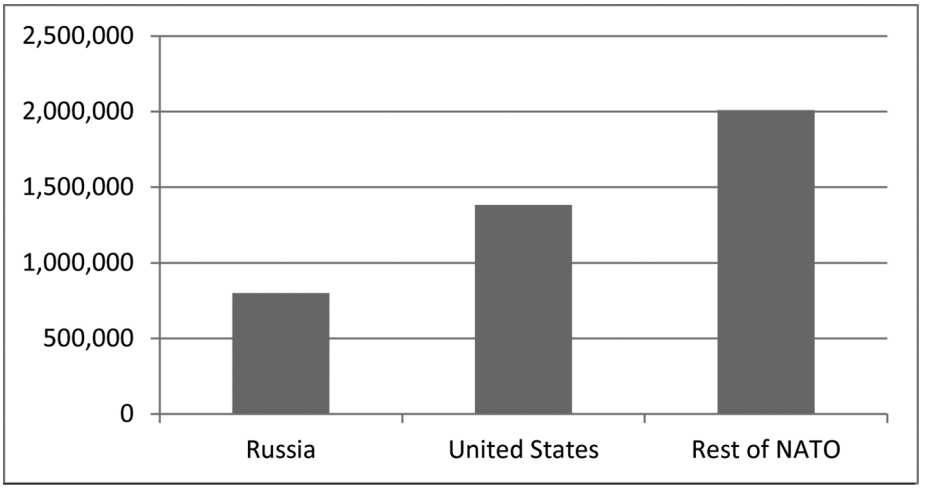


SOURCE: All data from The International Institute for Strategic Studies. *The Military Balance, 2016.* New York: Routledge, 2016.
Note: Data for 2013 provide for more accurate budget comparisons (i.e., before the Crimean invasion and the 2014–15 Russian economic shocks). NATO = North Atlantic Treaty Organization.

percent of gross domestic product in 2015), but that number is artificially inflated by Russia's poor economic performance. As Figure 72.1 shows, when real levels of military spending are compared, Russian spending is dwarfed by that of the United States and by the combined spending of the other NATO members. And while Russia's military modernization program has been relatively successful in recent years, reducing the role of conscription and improving readiness, the Russian military lags behind Western forces in technological sophistication. Similarly, the Russian military appears large when compared to small neighboring states like Lithuania or Estonia. Yet as Figure 72.2 illustrates, Russia's active duty military is actually smaller than either that of the United States or the other, combined, NATO allies.

Such simple comparisons, however, cannot adequately convey military readiness or strategic issues. As a recent RAND Corporation wargame noted, Russia could relatively easily and quickly conquer NATO member states in the Baltics; adding more "tripwire" forces to the region would do nothing to alter that outcome. In fact, this is not new. Throughout the Cold War, it was widely known in Western capitals that the Soviet

Figure 72.2
Comparative Active Duty Military Strength (2015)



SOURCE: All data from The International Institute for Strategic Studies. *The Military Balance, 2016.* New York: Routledge, 2016.
Note: NATO = North Atlantic Treaty Organization.

Union could easily conquer much of Europe with conventional forces if it chose to do so. Then and now, NATO's ability to escalate the conflict in the case of a Russian invasion remains its primary deterrent. For that reason, it is highly unlikely that Russia would consider intervention in the Baltics or other NATO member states. Indeed, as many experts have noted, Russia's force posture today gives no indication that it intends such aggression. In short, it is one thing to foment chaos in a troubled neighboring state. It is entirely another to risk intervention in a NATO member state, where U.S. treaty obligations compel a strong military response.

Russian aggression in eastern Ukraine, while abhorrent, thus poses no direct threat to the United States. Nonetheless, poor U.S.-Russian relations should still concern us. Growing tensions in Europe and troop buildups by both sides raise the risk of military conflict and even nuclear escalation. And outside Europe, Russian leaders have the potential to either impede U.S. foreign policy objectives (as in Syria) or enable them (as the Iranian nuclear deal illustrates). Tensions over Ukraine have largely overshadowed and prevented U.S.-Russian dialogue on various important issues, such as nonproliferation and arms control. Improving our relationship with Russia and ratcheting down tensions has the potential to alleviate U.S. foreign policy woes in Europe and elsewhere; it should be a top priority for policymakers.

The relationship has worsened substantially since Russia's military incursions into Ukraine, only six years after similar incursions into neighboring Georgia. Many date the start of the conflict to Russia's March 2014 seizure of the autonomous Ukrainian province of Crimea, home to the headquarters of the Russian Black Sea fleet. But the conflict's roots are much older: given Kiev's role as the cradle of Russian civilization, many Russians never fully accepted the country's independence following the collapse of the Soviet Union. Since independence, Ukraine's ethnic cleavages have produced confrontational and corrupt domestic politics that have alternated between Western-leaning and pro-Russian positions. The Maidan revolution of early 2014 grew out of those frustrations. Ukrainian President Viktor Yanukovych's refusal, under pressure from Moscow, to sign an association agreement with the European Union prompted street protests that soon turned into a violent revolution. Yanukovych fled to Russia, and a new pro-Western government was inaugurated. The violence was new, but the political divisions were not; indeed, Yanukovych himself had been previously displaced by pro-Western politicians in the largely peaceful 2004 Orange Revolution, only to be reelected president in 2010.

Although Yanukovych's ouster was consistent with the post-Soviet instability of Ukrainian politics, Russia's subsequent annexation of Crimea—followed by its aggressive involvement in arming pro-Russian rebels in eastern Ukraine—was unprecedented. Those actions presented a significant dilemma for American policymakers: Russian aggression did not pose a direct threat to U.S. interests, yet the move was a clear violation of international norms and raised the worrying possibility that Russia might try something similar in NATO member states. The issue was further complicated by Ukraine's corrosive culture of political corruption, the genuine—if minimal—support for the insurgency in the Donbas (eastern Ukraine) by some locals, and Russian official denials of their intervention despite strong evidence to the contrary. There were also more subtle protestations within the Russian establishment that its actions in Ukraine were justified by NATO "encirclement," specifically the violation of Cold War–era promises that NATO would not expand to the east.

After deliberation—and substantial public debate on the issue—the Obama administration ultimately decided against intervention and against arming Ukraine; the next administration would be wise to continue those policies. Two key factors militated against providing arms to Ukraine: (1) concerns about escalating the conflict, and (2) concerns that Ukraine's armed forces were too inefficient and corrupt to effectively use them. The

period since then has largely proved the wisdom of that choice: rather than escalating, the conflict has stagnated, and a ceasefire created by the second round of Minsk talks has kept violence at a much lower level since February 2015.

Instead of providing arms, the Obama administration chose to pursue a compartmentalized approach. Outside of Europe, the administration continued a pragmatic policy of diplomacy with Russia on issues like the Iranian nuclear deal. On European issues, in contrast, the administration engaged in a massively ambitious program of targeted sanctions. These sanctions made it difficult for various companies linked to the Russian government or to Kremlin cronies to raise money on international capital markets, to conduct joint ventures with U.S. energy and finance companies, and to access technology used for unconventional drilling projects. Yet the sanctions—even in conjunction with a crippling drop in global oil prices—have been largely ineffectual in altering the Kremlin's calculus on Ukraine. Worse, though they were designed to specifically target elites close to Russia's decisionmakers, the burden of sanctions—and of Putin's agricultural countersanctions—has fallen most heavily on the Russian population. The past two years have largely confirmed long-standing research on sanctions: they are rarely successful in changing state behavior, especially on issues of war and peace.

The difficult truth is that this failure leaves few good policy options on Ukraine. Moreover, any strategy that relies on coercion or threats—such as placing large numbers of troops in Europe—is unlikely to improve relations. Russian foreign policy decisions reflect Vladimir Putin's own insecurities, both international and domestic. The Kremlin fears looking weak to domestic audiences and has stoked nationalist and pro-Soviet sentiments in recent years to compensate for poor economic performance. In many ways, Russia fears being treated as if it is no longer a "great power," a fear that is worsened by NATO expansion. Increasing the Kremlin's perception of external threat is likely to result only in intransigence and further saber rattling, keeping tensions high in Europe and impeding U.S.-Russian cooperation on other issues.

As a result, finding a practical policy response to Russian aggression in Georgia and Ukraine—or to actions like the assassination of Aleksandr Litvinenko on British soil, or the increasing hostility that U.S. diplomats face inside Russia—is challenging for policymakers. Ultimately, Moscow's behavior carries few costs for the United States. In contrast, any cost-benefit analysis would argue strongly that the risk and potential costs of a

conflict with Russia dramatically outweigh the possible benefits of drawing Ukraine closer to the West. Put simply, Russia will always have more at stake in Ukraine than the United States does.

For all these reasons, diplomacy remains the best approach to resolving the many challenges posed by Russia, including the Ukraine crisis. The Minsk process has been slow, driven by the willingness of French and German diplomats to take the lead, yet it still offers the best chance for a peaceful resolution to the conflict. Offering sanctions relief in exchange for successful implementation of the Minsk process could contribute to diplomatic success. But it is also important to be realistic about what can be achieved through diplomacy and sanctions. Crimea is lost to Ukraine, and although the Minsk process can likely stabilize the rest of the country, Ukraine will have to weigh for itself the costs and risks of future conflict with Russia against the benefits of joining either NATO or the European Union. Neither Crimea nor a neutral Ukraine presents a major loss for U.S. interests; yet accepting these unpleasant realities is likely to be unpopular, particularly among those who see NATO less as a mutual defense pact and more as a mechanism for incorporating and socializing democratizing states in Eastern Europe into the transatlantic community. There are other obstacles too: Russia's role as aggressor often obscures the fact that Ukraine's elites remain corrupt, disorganized, and often unwilling to make necessary political reforms. To succeed, pressure must be brought to bear not only on Russia, but also on Ukraine's government to fully implement the political provisions of the Minsk process, including local elections in the Donbas.

Some other concrete policy solutions may prove useful. Though current sanctions have been largely ineffectual, sanctions that focus on impeding military modernization are likely to be more useful than those aimed directly at Russia's leaders. Indeed, the combination of sanctions on electronic components and the shutoff of military trade with Ukraine—which was a major supplier of engines for military use—has impeded Russia's ability to manufacture helicopters and frigates, as well as some ship and heavy-lift capabilities. By making it harder to obtain high-tech components in particular, military-industrial sanctions can weaken Russia's ability to fight in the future.

Continuing diplomatic work with Russia, independent of ongoing events in Ukraine, has the potential to yield agreements that likely couldn't be achieved otherwise—as the Iranian nuclear deal highlighted. While Russia certainly does not—and should not—possess a veto on U.S. foreign

policy objectives around the world, the Syrian crisis has powerfully illustrated Russia's ability to make life more difficult for the United States if it so chooses. Moving forward, Russian diplomatic support will be particularly valuable in pursuing a solution to the crisis in Syria, given Moscow's strong influence over the Assad regime.

Russia's behavior in Ukraine has been deplorable. Yet it is also a striking illustration that—however we may pretend otherwise—U.S. foreign policy tools cannot always force other states, particularly major powers, to act as we wish. When the benefits of increased U.S. intervention in Ukraine are compared with the costs of a potential conflict with Russia, it is clear that military solutions are not viable. At the same time, continued poor U.S.-Russian relations have the potential to cause future conflict and to undermine U.S. foreign policy objectives elsewhere. Instead of seeking to ratchet up tensions, therefore, policymakers should continue to pursue a diplomatic solution to the crisis in Ukraine, focus on inhibiting Russia's military modernization where possible, and seek a constructive working relationship with Russia on non-European diplomatic issues, such as nonproliferation and ending the Syrian civil war.

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—Prepared by Emma Ashford

73. East Asian Security

Policymakers should

- recognize that America's allies in East Asia are not doing enough to provide for their own defense;
- encourage allies and partners to do more for their own defense by gradually drawing down America's military presence;
- support efforts by allies and partners to enhance their military capabilities;
- sell military equipment to friends and allies, especially those that emphasize low-cost, asymmetric responses to Chinese capabilities; and
- endorse increased security cooperation among East Asian countries without U.S. involvement (e.g., bilateral and multilateral cooperation with India and Japan).

The network of U.S. alliances in East Asia that has undergirded American military dominance in the region since the end of World War II faces serious strain. China and North Korea present the two most serious challenges to East Asian security, the former because of its growing economic and military power and the latter because of its nuclear weapons program and unpredictable truculence. Growing threats in East Asia and increasing global demands on the U.S. military, combined with rising financial demands at home, make it increasingly difficult to sustain credible security commitments to America's East Asian allies. Adding to the difficulty is the asymmetric relationship between the United States and many of our East Asian allies who get a cheap ride because of U.S. commitments, whereby the United States shoulders a large portion of their defense burden. This is not to suggest that American alliances in East Asia have

no value, but U.S. policymakers should update Washington's security ties to keep pace with a changing international environment.

Countries such as Japan, South Korea, and Taiwan with large, modern economies should be doing more to address the security challenges posed by China and North Korea. Although America's allies and partners may never be able to match the size of China's military, they are able to field high-quality forces capable of defending their interests. Such a shift among East Asian states would move the United States away from its current position of primacy to one of balancer-of-last-resort.

To their credit, U.S. allies have already started moving in the right direction as a result of aggressive Chinese and North Korean behavior in recent years. However, those same aggressive moves have also put pressure on Washington to send more military support to East Asia. Instead of deploying additional military forces and offering further reassurances or commitments, the United States should encourage friendly states to do even more for their own defense. In the short term, that means capping the number of U.S. military personnel and amount of equipment deployed in the region. In the long term, Washington should slowly but consistently reduce U.S. guarantees and deployments, which would give allies time to improve their defenses and shoulder more of the burden. Abruptly abrogating treaty commitments would be a mistake.

Japan

Japan is simultaneously the biggest beneficiary of U.S. security commitments and the most capable of defending itself without them. To start, although Japan's economy has struggled to grow since 1990, it remains one of the world's top economies. In addition, the Japan Self-Defense Forces (JSDF) employ some of America's best weapons, and Japan's defense industry is capable of producing high-quality military equipment as well. Despite this latent national power, however, Japan largely depends on the United States for its security. According to the Defense Manpower Data Center, in September 2015, more than 52,000 American military personnel were stationed in Japan, the largest contingent of U.S. troops in any country outside the United States. One barrier to larger Japanese investment in self-defense is opposition among the Japanese people to a larger or more aggressively oriented military. For example, in 2015, large demonstrations took place in opposition to reforms that enable the JSDF to come to the aid of friendly countries if the latter are attacked first (the reforms were approved). Turning Japan into a more equal defense partner

with the United States will be a long, difficult process, despite Japan's great potential.

The behavior of other states in Japan's neighborhood has created a pressing need for a stronger JSDF. China has increased its naval, coast guard, and air force activity in the vicinity of the Senkaku/Diaoyu islands in the East China Sea, prompting the JSDF to scramble military aircraft 571 times in 2015. Aggressive Chinese behavior in the South China Sea has understandably raised alarm in Tokyo as well. Beijing's actions have prompted concern in Tokyo about the reliability of the U.S. defense commitment. As one Japanese official noted, "Unless Japan shows that it is prepared to fight together with the United States when the time comes, the United States will say to Japan . . .`OK, sayonara.'"

There have been some positive developments, such as the legislation permitting the JSDF to come to the aid of allies under attack, slow but steady increases in defense spending, and expanding cooperation with other Asian states. And in 2016, elections for the upper house of the Diet, Japan's legislature, resulted in a big win for Prime Minister Shinzo Abe's Liberal Democratic Party, which may advance the government's proposed defense reforms.

U.S. policymakers should encourage Japan to continue transforming its defense posture. Recent reforms have come in response to threats from China and reflect the past pattern of U.S.-Japan relations. As Dartmouth's Jennifer Lind notes, "Japan does less when it can; more when it must." The best way to encourage meaningful reforms and burden sharing is to slowly reduce the U.S. military presence in Japan. U.S. ground forces should be phased out first, as they are poorly suited for responding to the naval and air threats posed by China. The priority of the remaining U.S. military assets should be the defense of Japan's home territory, not the uninhabited Senkaku/Diaoyu islands. Finally, U.S. policymakers should encourage security cooperation between Japan and other states in East Asia, especially South Korea, and Asian states further afield, such as India. Greater focus on multilateral efforts could make up for a decreased American role in the alliance and should be a priority for Tokyo, given past fears rooted in World War II.

South Korea

Approximately 25,000 U.S. troops are stationed in South Korea (ROK), largely to deter an attack by North Korea (DPRK), but these troops are not necessary. On most measures of power, including military, the ROK

is much stronger than the DPRK. With a 2-to-1 population advantage, a 40-to-1 edge in gross domestic product, a strong indigenous defense industry, and much broader international support, the ROK is capable of deterring a conventional attack by the DPRK without U.S. assistance. Washington should not dictate any particular defense outcome for South Korea. The United States should simply turn military responsibilities over to Seoul, to be handled as the latter sees fit. Of course, American officials should seek to make the transition as smooth as possible.

Although the ROK is capable of mounting an effective conventional defense of its territory, it is not as well equipped to counter the serious threat posed by the DPRK's nuclear arsenal. Presently, the United States' nuclear umbrella over South Korea is meant to deter Pyongyang from using nuclear weapons first. Missile defense could also help protect the South from nuclear attack.

The most straightforward nuclear deterrent would be for Seoul to develop nuclear weapons of its own. Indeed, even the threat that the ROK would be allowed to develop its own nuclear weapons could encourage Beijing to act more decisively to dismantle the North's nuclear arsenal. However, the negative consequences of ROK nuclearization could be serious. ROK acquisition of the bomb could encourage further nuclear proliferation in East Asia with unpredictable consequences.

Solving the various security problems posed by the DPRK likely will require help from China, which continues to prop up Kim Jong-un's regime. Beijing's main concern has been the impact of a North Korean collapse and a reunified Korea allied with the United States. And some in Beijing believe that the true long-term goal of the U.S.-ROK alliance is the containment of China. However, China has been increasingly willing to criticize the DPRK's provocative actions, such as the latter's 2016 nuclear and missile tests, and to support tougher multilateral sanctions. Addressing Chinese concerns over the prospect of a North Korean implosion and U.S. relations with the ROK could encourage China to further reduce its support for the DPRK. Washington must convince Beijing that acting against Pyongyang serves its own interest as well as that of the United States.

Policymakers should make three changes to U.S. military deployments in and policies toward the Korean peninsula. First, all U.S. ground forces should be withdrawn in a gradual process that gives the ROK military time to exercise greater responsibility. Cuts in force structure would lower U.S. expenditures, while reductions in the American garrison would free

up ROK "host nation support" funds to increase South Korean military spending.

Second, policymakers should do more to engage the DPRK regime. Current U.S. policy based on denuclearization and diplomatic isolation has been a resounding failure. Washington should drop denuclearization as its primary goal in an effort to re-engage with the DPRK bilaterally. If the North genuinely fears military action by the United States, reducing America's military presence in the ROK should help facilitate negotiations. Although expectations should be kept low, Pyongyang might agree to steps short of denuclearization, such as limits on future weapons development and reductions in its conventional forces. Even if talks failed, the attempt at engagement would address Chinese complaints that Washington has refused to address legitimate DPRK security concerns.

Finally, the United States and the ROK should encourage China to take a more active role in pressing North Korea to denuclearize. Those efforts should include discussing issues that might arise from the collapse of the existing DPRK regime as well as providing credible guarantees that America's military presence on the Korean peninsula would end in the event of reunification.

Taiwan

The U.S.-Taiwan relationship is not a formal alliance; rather, the United States has an implicit commitment to defend Taiwan based in the Taiwan Relations Act of 1979. That vague commitment was once enough to deter Chinese aggression and restrain Taiwanese politicians, but China's growing military power is weakening Washington's credibility. Armed conflict over Taiwan is unlikely in the near future. Still, China's growing military power will make it more costly for the United States to fulfill its commitment over time.

Policymakers in Taipei recognize the dangerous position they are in and have taken some positive steps to provide for their own defense. One of President Tsai Ing-wen's campaign pledges was to improve Taiwan's defense industry so it could provide more indigenously produced defense equipment. Taiwan's navy recently announced a $14.6 billion shipbuilding plan over the period 2017–2040. However, only 3 of the 12 proposed projects have been approved thus far, and some people in Taiwan are concerned that the country cannot afford the full plan. Policymakers in Washington should encourage this process, explaining that the likelihood of American military intervention diminishes as China's military capabili-

ties increase. U.S. policymakers should continue to sell arms to Taiwan, but they should also encourage Taipei to emphasize less-expensive capabilities that can deny China a quick victory over Taiwan, such as mobile surface-to-air and anti-ship missile systems like the Tien Kung-III and Hsiung Feng-III, respectively.

Ultimately, the U.S. should end any commitment, implicit or otherwise, to use military force to aid Taiwan, though we should not step back from the commitment too quickly. The United States should work toward cross-strait peace and stability, but Taiwan can and must play a much greater role in deterring conflict. Taking some difficult steps now would push Taiwan toward a sustainable defense strategy that would be more reliable than depending on the United States.

U.S. Allies and Partners in the South China Sea

The territorial dispute in the South China Sea will require a great deal of attention in the near term. Chinese activities, particularly island-building, in the South China Sea have antagonized many Southeast Asian states, including the Philippines, a treaty ally, and Vietnam, a friendly American partner. Demonstrations of American interest and political will in the South China Sea—such as military exercises with the Philippines, the lifting of the arms embargo on Vietnam, and U.S. Navy patrols near Chinese-claimed islands—have not caused China to back down from its central claims or to cease its activities. In fact, Beijing has used American actions to justify increasing its military presence in the South China Sea.

The Philippines and Vietnam have reacted to China's behavior through a mix of "soft" and "hard" balancing. The most notable example of soft balancing was the legal case brought against China by the Philippines before an arbitration tribunal established at the Permanent Court of Arbitration in The Hague. In early July 2016, the tribunal issued its final ruling in the case, which was overwhelmingly in the Philippines' favor. The court declared that "China's claims to sovereign and historic rights with respect to the maritime area encompassed by the `nine-dash line'" were unlawful and admonished China for its aggressive behavior in the South China Sea. Hopes that the ruling would serve as a legal basis for reducing tensions have yet to be realized. As of this writing, Beijing has not taken significant escalatory actions, such as declaring an air defense identification zone or withdrawing from the United Nations Convention on the Law of the Sea; but it has refused to accept the tribunal's ruling and has taken other

actions that make de-escalation difficult, such as conducting patrols around disputed features with bomber aircraft.

Vietnam has leaned toward hard balancing and responded to Chinese aggression by increasing its military power and drawing closer to the United States. In a notable addition to its arsenal, Hanoi purchased six Kilo-class diesel-electric submarines from Russia—the fifth was delivered in February 2016. In early June 2016, Indian Prime Minister Narendra Modi's government reportedly ordered BrahMos Aerospace, an India-Russia joint venture, to accelerate efforts to sell anti-ship cruise missiles to Vietnam. The previous month, President Barack Obama announced that the United States would lift an American arms embargo on Vietnam. Access to American military technology will help Hanoi's balancing effort, but the United States should be wary about offering more formal commitments, such as security guarantees, to Vietnam.

Policymakers should tread carefully in matters relating to the South China Sea. Washington should avoid a military confrontation with China over contested territory. The United States should indicate that it takes no position on particular claims but emphasize the importance of creative and peaceful resolution of disputes. Policymakers should provide financial or material assistance to states like Vietnam and the Philippines to improve their self-defense capabilities.

Conclusion

The days of allies in East Asia relying on U.S. commitments for their defense must end. Friendly states face serious security challenges, but they also have the capacity to defend themselves. Current alliance policies are not sustainable; U.S. commitments cannot keep pace with developing threats. Instead, allies must develop their own diplomatic, economic, and military capabilities. To encourage friendly nations to do more, Washington should gradually reduce current support levels. Shifting defense responsibilities to where they belong, on prosperous allied states, is neither abandonment nor isolationism. Rather, it is good security policy. Policymakers should undertake an orderly retrenchment to improve America's long-term position in East Asia.

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—Prepared by Doug Bandow and Eric Gomez

74. NATO Policy

Policymakers should

- avoid escalating tensions with Russia, especially along its western border;
- insist that no new members be added to NATO;
- increase pressure on NATO members to fulfill immediately the commitment they made at the 2006 summit to devote at least 2 percent of their gross domestic product to defense;
- begin a phased drawdown of all U.S. forces in Europe and begin the process of transferring full responsibility for European defense to the European Union and other significant European actors, such as the United Kingdom; and
- announce that it is the intention of the United States to withdraw from the North Atlantic Treaty by April 2024, the 75th anniversary of the treaty.

The creation of the North Atlantic Treaty Organization (NATO) in 1949 represented the most explicit break with America's traditional policy of avoiding foreign alliances and generally charting a noninterventionist course. Being drawn into two major wars in little more than a generation—and especially the psychologically devastating attack on Pearl Harbor—had struck a fatal blow to a noninterventionist foreign policy. Even prominent noninterventionists such as Sen. Arthur Vandenberg (R-MI) concluded that the world had changed and that "isolationism" (a poisonous misnomer) was no longer an appropriate policy for the United States. Joining NATO, the ultimate in "entangling alliances" with European powers, confirmed the extent of the shift in Washington's policy and American attitudes.

It was hard to dispute the "world has changed" argument. There was no semblance of a European or a global balance of power in the late 1940s

or early 1950s. Central and Eastern Europe were under the domination of the Soviet Union, a ruthless totalitarian power that posed an expansionist threat of unknown dimensions. Western Europe, although mostly democratic, was badly demoralized from the devastation of World War II and the looming Soviet menace. Even prominent noninterventionists such as Sen. Robert A. Taft (R-OH) were not prepared to cut democratic Europe loose in such an environment. But Taft wanted merely to offer the Europeans a security guarantee, not have the United States take the fateful step of joining NATO and assuming virtually unlimited leadership duties for an unknown length of time. Subsequent developments validated his wariness.

NATO partisans insisted that the world changed with World War II and that the new paradigm required extensive U.S. leadership. The problem with their analysis, especially as the decades have passed, is that they seem to assume that change is a single major event and everything thereafter operates within the new paradigm. That assumption is totally false. Change is an ongoing process. Today's Europe is at least as different from the Europe of 1949 as that Europe was from pre–World War II Europe. Yet the institutional centerpiece, NATO, and much of the substance of U.S. policy remain the same.

Even though Russia is now a weakened power with regional ambitions rather than a malignantly expansionist totalitarian state with global ambitions, NATO officials treat Moscow as though little has changed since the days of Leonid Brezhnev, if not Joseph Stalin. Yet Russia, with 142 million people, has less than 60 percent of the population of the old Soviet Union—and it is an aging population with a declining average lifespan. The Russian economy is likewise much smaller (only $1.3 trillion), and it is both fragile and one dimensional, with a heavy dependence on energy exports. In short, Russia is simply too weak to pose a conventional challenge to much of Europe.

Nevertheless, U.S. officials have viewed Moscow's annexation of Crimea and its support for pro-Russian separatists in eastern Ukraine as the harbinger of much wider aggression. A more plausible interpretation is that those moves were an effort by Vladimir Putin's government to strengthen security along Russia's western border against what Russian leaders see as a dangerous eastward expansion of NATO.

Instead of responding as the United States and its NATO allies have done with military exercises and new military deployments in Eastern Europe, they should move more cautiously and be mindful of Russia's longstanding security concerns in that region.

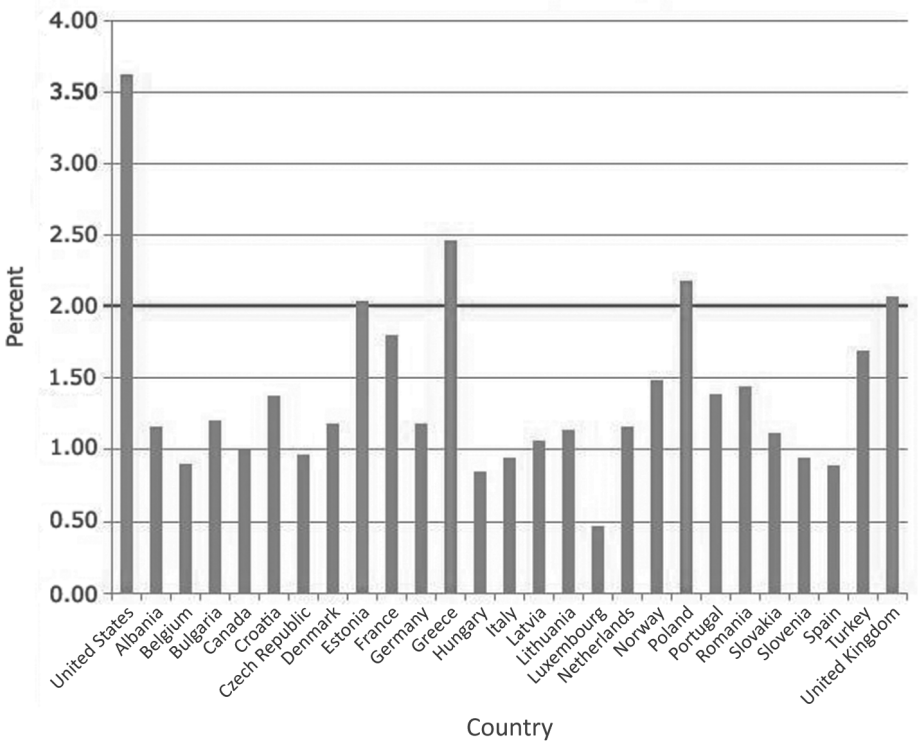
U.S. and Russian interests on a variety of important issues, including counterterrorism, coincide more than they conflict, so maintaining decent relations with Moscow makes good strategic sense. It also would be the height of bitter irony if, having escaped a direct military clash with the Soviet Union (a truly dangerous adversary) during the Cold War, NATO stumbled into conflict with a mundane Russia because of a needlessly inflexible and confrontational approach. Yet that is now a real danger unless U.S. and NATO policy changes dramatically.

One relatively easy step that the United States can take is to veto any move to add new members to NATO. Some candidates are not necessarily in Russia's security zone. The newest alliance member, for example, Montenegro, is in the Balkans. The most discussed potential members, though, such as Georgia and Ukraine, would trigger a crisis with Moscow. Only the most reckless policymakers should wish to go down that path. Moreover, adding an assortment of small, militarily insignificant "allies" does nothing to benefit America's security and well-being. Indeed, when those small security dependents are on bad terms with a great power neighbor, they can greatly endanger America's security by triggering an unnecessary armed conflict. We already have that risk with the three Baltic republics, given their fraught relations with Moscow. Adding Georgia or Ukraine to the alliance would greatly compound the danger.

Although the United States should push NATO to adopt a more conciliatory policy toward Russia, Washington also needs to make clear to the other alliance members that the days of free riding on America's security exertions have ended. There is an especially annoying gap between the rhetoric of those European members who cite a rising Russian security threat and their commitment to fulfilling the pledge made at the 2006 summit to devote at least 2 percent of annual gross domestic product (GDP) to defense. Some still fall short—often far short—of that amount. Only 4 of the 28 members (other than the United States) fulfill the 2 percent pledge, and 2 of them (Estonia and Poland) have done so just recently (see Figure 74.1). Indeed, several key NATO members, including Germany, Italy, and Spain, hover around 1 percent. If NATO's European members want to present a credible deterrent to Russia, they need to do more—unless, of course, they are simply relying on the United States to handle their security needs.

Washington has complained about the lack of burden sharing for decades and gained little satisfaction. When the European allies have not ignored U.S. protests entirely, they've made paper promises—as with the

Figure 74.1
NATO Country Defense Spending as a Share of GDP, 2015



SOURCE: NATO, *The Secretary General's Annual Report, 2015*.

2 percent pledge—that are soon forgotten. The United States needs to move beyond burden sharing to *burden shifting*. Europe is no longer a collection of demoralized, war-ravaged waifs, as it was when NATO was created. Most of the European democracies are now banded together in the European Union (EU), with a population and collective GDP larger than that of the United States. Although they are troubled by the turbulence in the Middle East and the occasional growls of the Russian bear, they are capable of handling both problems. As noted, Putin's Russia is a pale shadow of the threat once posed by the Soviet Union. The EU has three times the population and an economy more than 10 times that of Russia. Although Britain's probable departure following the Brexit vote will shrink the EU modestly, it remains an impressive collection of major powers. The primary reason that the EU countries have not done more to manage the security of their own region is that the United States has insisted on

taking the dominant role—and paying a large portion of the costs. From the standpoint of American interests, that is a myopic, self-destructive policy that needs to change immediately.

The new administration should move on two policy fronts. First, it should explicitly reverse U.S. policy and strongly encourage the EU to take on security responsibilities. That change also means that the EU needs to work with NATO countries that are not EU members (e.g., Turkey) or will cease being part of the union (Britain). Among other steps in this transfer of security responsibilities, the next commander of NATO forces should be a European, not an American.

Such burden shifting is long overdue. In terms of geographic proximity alone, the European powers should be more concerned than the United States about developments in both Eastern Europe and the Middle East. Yet we currently have the opposite situation. Countries that are directly exposed to developments in those regions defer to the United States for crucial policy decisions, and America incurs a disproportionate degree of the costs and risks of implementing NATO's policies. That situation needs to change.

NATO's overall strategic orientation has become alarmingly diffuse. When one of the most prominent missions of the "North Atlantic" alliance is a seemingly endless counterinsurgency and nation-building venture in Afghanistan, that suggests NATO's leaders have lost their strategic bearings. Although Washington was able to entice and cajole some of the European members to participate in that out-of-area intervention, that achievement was in the best interests of neither the United States nor those countries. A new European security entity should, and would be more likely to, focus on the more pressing security needs of democratic Europe and its surrounding neighborhood instead of being a junior partner in geographically remote, quixotic crusades.

In addition to the general policy shift, the new administration must commence a significant redeployment of U.S. forces from the European theater. Within a four-year period, the United States ought to withdraw all of its ground forces from Europe. It should also reduce its naval and air forces there by at least 50 percent by that same target date. Such a schedule will convey to the European allies both the seriousness of Washington's intentions and the urgency of a constructive response on their part to replace those forces.

The ultimate goal of the policy shift should be nothing less than the withdrawal of the United States from the North Atlantic Treaty Organiza-

tion. The new administration should immediately inform the other NATO members of Washington's intention to execute that withdrawal by April 2024, the 75th anniversary of the treaty. Seventy-five years is an exceedingly long period for any policy to be relevant and beneficial, and America's NATO membership is no exception. It is important not to extend the withdrawal process beyond a 2024 deadline. A longer time frame would merely tempt the European allies to spend the first several years lobbying the United States to reverse its decision. The 2024 deadline gives the allies sufficient time to forge a credible defense and foreign policy successor—if they move promptly to adjust to the new reality.

NATO was created to meet a specific threat in a specific setting. The alliance provided a needed U.S. security shield to protect vulnerable key European democratic powers that had not yet recovered from the devastation of World War II and faced a large, extremely dangerous, totalitarian adversary in the form of the Soviet Union. But what should have been an emergency departure from America's wise tradition of avoiding entangling alliances has become a permanent, needlessly risky burden in a vastly changed world. With today's NATO, the United States is obligated to defend 27 fellow members—most of which are not strategically important to this country. Furthermore, most of the newer members are so small as to provide no meaningful addition to America's own military strength. That characteristic, combined with the dicey relations that several of them have with larger neighbors, makes them strategic liabilities, not strategic assets. Equally troubling, some of the members, especially Turkey and Hungary, are exhibiting such pronounced authoritarian tendencies that it is not always easy to distinguish their behavior from that of outright autocratic regimes like Putin's Russia. It would be awkward, at the very least, to risk America's security and well-being to defend such clients.

NATO is an institutional dinosaur that has outlived whatever usefulness it might once have had. The new administration's short-term goal should be to repair relations with Russia and reverse the slide toward a new cold war. The incoming administration also must increase pressure on the European members to fulfill the defense spending commitments they have already made. Longer term, U.S. policymakers need to change the terms of the policy debate, transferring to the European allies full responsibility for their own defense and the security of their region and extricating the United States from an obsolete security obligation.

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—Prepared by Ted Galen Carpenter

75. The International War on Drugs

Policymakers should

- declare an end to the international war on drugs and recognize that it has stimulated an increase in violence in drug source and transit countries while producing few intended results;
- recognize that prohibition creates a huge black-market premium and potential profit from drug trafficking that terrorist groups will exploit; and
- accept the legalization, decriminalization, and harm-reduction strategies adopted by Uruguay, the Netherlands, Portugal, and other countries as a better model for dealing with the problem of drug abuse.

Drug trafficking is one of the most resilient and lucrative industries in the world, with estimated revenues of $300 billion a year. Despite the tens of billions of dollars that Washington and other governments spend every year trying to disrupt them, drug-trafficking organizations have shown tremendous ingenuity, adaptability, and entrepreneurship to satisfy over a quarter billion customers worldwide.

The debacle of the war on drugs is obvious to any independent observer. In 1988, the United Nations held a conference titled, "A drug-free world: we can do it." Since then, consumption of marijuana and cocaine has increased by 50 percent. Even the U.S. government admits its own failures in stopping the flow of drugs: the 2015 *National Drug Threat Assessment* by the Drug Enforcement Administration states that, while cocaine availability in the United States has stabilized in recent years, marijuana, heroin, and methamphetamines are increasingly available across the country.

In the 1970s, leading economists such as Nobel laureates Milton Friedman and Gary Becker were among the first to point out the futility of drug

prohibition, citing the laws of supply and demand. These lessons became more relevant as drug violence reached gruesome levels in Mexico and Central America in the past decade. Former Mexican President Felipe Calderon kicked off his presidency in December 2006 by launching an all-out military assault against cartels that claimed over 100,000 lives, but even he had to acknowledge the futility. Describing the economic dynamics of illicit drug trafficking, he said: "If the price goes up [thanks largely to interdiction efforts] and the demand is the same, you will increase profits so you are creating more incentives for participants in the market. And it's clearly a textbook case of an unstable economic system in which the more successful you are, the more criminals you are creating."

The dynamics of drug trafficking are best illustrated by what happens to a kilogram of cocaine from its elaboration in the Andes to its distribution and sale in the United States. Nearly 350 kilograms of dried coca leaves are required to produce 1 kilogram of cocaine, at a cost of approximately $385. Once it has been turned into white powder, the kilogram costs $800, but its value goes up to $2,200 by the time it is exported from Colombia. When it reaches the United States the product increases in value to $14,500, but it can be sold at a retail price of $122,000—a 32,000 percent markup from the raw product.

The logic behind prohibition is that the more the price of a drug goes up, the less consumption there will be. However, research shows that the demand for drugs is inelastic—that is, even if the price goes up, consumption remains more or less the same. Therein lies the problem with Washington's supply-side campaign against narcotics: it significantly inflates the price of drugs, but it does not reduce demand meaningfully. The result is that the value of the market increases and thus its appeal to violent criminals. It is not a coincidence that, according to the *Global Study on Homicide 2013* published by the United Nations Office on Drugs and Crime, 8 of the 10 countries with the highest murder rates in the world were located precisely along the cocaine route from the Andes to the United States.

The international war on drugs has also unwittingly served to support terrorist groups that have benefited financially from the enormous profits that the anti-drug campaign has produced. Counternarcotic strategy thus conflicts with sound foreign policy goals, namely the encouragement of peace and the strengthening of the institutions of democracy and civil society.

Around the world, there is a growing realization that the current prohibition on most drugs needs to be replaced with more sensible policies.

Despite this mounting consensus, the nature of the "drug problem" is still hotly debated, and thus the alternative policies have yet to be agreed on.

Assessing Alternatives

The predominant view in Washington's power circles is that the present strategy is a failure not because drug laws are flawed, but because of weak institutions in producing and transit countries. The solution, according to this analysis, is greater security and intelligence cooperation among nations; more expenditure in the security and judiciary apparatuses; and tougher laws dealing with corruption, gun trafficking, and money laundering.

Developing countries indeed suffer from weak institutions. But drug prohibition actually exacerbates this institutional problem by inflating the profit margins of organized crime to stratospheric levels, thus increasing its corrupting and violent power. For example, a study by the United Nations Development Programme pointed out that, in 2010, the seven Central American governments spent a combined $3.97 billion on security and their justice systems. That sum represents a 60 percent budget increase since 2006. Yet the figure falls short of the estimated revenues of the Colombian and Mexican drug trafficking organizations, which, according to a report from the U.S. Justice Department, could reach up to $39 billion annually.

Another challenge is the disparity among countries in their institution-building efforts, which leads to the balloon effect of criminal activities. This is perhaps the main feature of the drug business: its ability to adapt to changing circumstances. For example, in the early 1990s, as pressure grew on coca growers in Peru, those crops moved to Colombia. After a decade of eradication programs in that nation, coca growers moved back to Peru. Now Colombia has retaken its spot as the world's leading coca producer. Despite the back and forth, the Andean region continues to produce the same amount of cocaine as it did 20 years ago.

Over the years, the most common approach to the war on drugs has been the attempt by governments in producing and transit countries to export the problem to their neighbors. Greater cooperation, harmonization of efforts, and same-pace institution building seems unrealistic.

In some countries, the challenge is even greater given the active presence of terrorist organizations. For decades, for example, the Revolutionary Armed Forces of Colombia (FARC) rebel group has derived hundreds of millions of dollars from the cocaine trade. That involvement has prolonged

and fueled a conflict for more than 50 years and will continue to be a destabilizing factor even if the government and the FARC reach a lasting peace agreement. In Pakistan, the Taliban reaps about $700 million dollars per year from the poppy and heroin trade. In Syria and Iraq, the Islamic State of Iraq and Syria (ISIS) derives up to 7 percent of its revenue from the illicit drug industry. The huge black-market premiums that result from prohibition are obviously undermining efforts to strengthen democratic institutions in those cases and undermining legitimate national security goals.

An alternative is for one country or a group of countries to turn a blind eye to drug distribution, without legalizing or decriminalizing the drug trade, while focusing their police resources on violent crimes. However, as long as the drug trade remains illegal, such a policy wouldn't likely avoid the effects of prohibition.

In Mexico in the 1970s and 1980s, the authorities adopted a complicit approach to drug trafficking: the federal government looked the other way while drugs were shipped to the north. But drug trafficking at that time was conducted mostly by a single organization; today, several powerful and violent Mexican cartels fight each other for control of trafficking routes. Even if the Mexican government were to adopt a hands-off approach to drug smuggling, that would not prevent the cartels from engaging in bloody turf wars. Drug violence might decline, since government intervention adds volatility to a changing cartel landscape, but Mexico would likely remain a violent country.

Moreover, a drug-producing or transit nation that decides to abandon the fight against drug trafficking could become a safe haven for kingpins. Drug money would likely flow into that country's economy, potentially corrupting institutions and even civil society. Still, given Washington's obstinacy with prohibition, several governments in the region might be tempted to follow this path to reduce the staggering levels of violence afflicting their countries.

Finally, there is the increasingly accepted assessment that the problem with the international war on drugs is not the illicit substances but prohibition. In recent years, a growing number of high ranking officials around the world, including sitting and former presidents, have called for the adoption of a legal market for certain drugs, starting with cannabis. There are already well-known precedents: in 2013, Uruguay became the first country to fully legalize marijuana. In the United States, 28 states have legalized the medical use of marijuana; Colorado, Washington, California,

Nevada, Maine, Massachusetts, Oregon, and Alaska have legalized recreational use as well, and more states will surely do so in the near future.

Some European countries—such as Portugal and the Netherlands—have opted for implementing harm-reduction policies, either de facto or de jure. In 2001, Portugal decriminalized all drugs, including cocaine and heroin. Not only has the predicted spike in drug use and a public health crisis failed to materialize, Portugal's drug usage rates compare favorably with many other European states that have maintained a more severe approach, and in some cases, its usage rates have dropped.

Even though the terms of the debate have shifted significantly in favor of legalization as an alternative to the war on drugs, the discussion has focused almost exclusively on marijuana. Indeed, the momentum toward a legal market for cannabis seems unstoppable: a poll in October 2015 showed that 58 percent of Americans favor legalizing the drug. Assistant Secretary of State for International Narcotics and Law Enforcement William Brownfield has said that legalizing cocaine, heroin, methamphetamine, and synthetic drugs would constitute crossing a "red line" for Washington. Tellingly, he did not mention marijuana. However, the problem in most countries around the world that are besieged by drug violence is not particularly marijuana trafficking, but the prohibition of other drugs, especially cocaine and heroin. Given the failure of the international drug war to stop the flow of narcotics into the United States, and given the benefits of the harm-reduction approach that treats drug addiction as a social problem rather than a criminal problem, clearly, the end of prohibition must include the whole range of narcotics.

Toward a Constructive Approach

Washington's international drug war has been disastrous. Production of drugs in foreign countries has increased, and the flow of drugs to the United States has continued. As Tom Wainwright from *The Economist* summarizes, "the `all-out war' approach has failed to cut the number of consumers, while it has driven up the price of a few cheap agricultural commodities to create a hideously violent, $300-billion global industry." The impact of the U.S. war on drugs has severely aggravated political, economic, and social problems in developing countries. Attempts to escalate the drug war, even in a dramatic way, will do little to change those realities.

As the world's largest consumer of illicit drugs, it is the responsibility of the United States to encourage the worldwide shift away from prohibition

toward the creation of markets and civil society by ending its international crusade against drugs. Doing so will hardly affect U.S. drug consumption, due to the inelasticity of demand, but it would at least acknowledge that narcotics abuse is a domestic social problem that foreign policy cannot solve.

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—Prepared by Juan Carlos Hidalgo and Ian Vásquez

76. Nuclear Weapons: Proliferation and Terrorism

Policymakers should

- seek to dampen excessive alarmism over the issues of nuclear proliferation and atomic terrorism;
- consider that nuclear proliferation is unlikely to accelerate or prove to be a major danger;
- be wary of the potentially destructive consequences of some counter-proliferation policies;
- understand that one way to reduce the likelihood that errant regimes will seek nuclear arsenals is to stop threatening them; and
- recognize that the likelihood terrorists will be able to acquire a nuclear capacity is vanishingly low.

The foreign policy establishment has long taken it as a central article of faith that the proliferation of nuclear weapons is an overwhelming danger and that great efforts, including perhaps even war, must be undertaken to keep it from happening. Alarm escalated after the experience of September 11, 2001, which raised concerns that terrorists might obtain nuclear weapons—even though the terrorists on that tragic day used weapons no more sophisticated than box cutters.

However, nuclear proliferation is unlikely to accelerate or prove to be a major danger. Terrorists are likely to continue to find that obtaining and using nuclear weapons is exceedingly difficult. And aggressive counter-proliferation policies can generate costs far higher than those likely to be inflicted by the proliferation problem they seek to address. Those policies need careful reconsideration.

Nuclear Proliferation

Except for their effects on agonies, obsessions, rhetoric, posturing, and spending, the consequences of nuclear proliferation have been largely benign: those who have acquired the weapons have "used" them simply to stoke their egos or to deter real or imagined threats. For the most part, nuclear powers have found the weapons to be a notable waste of time, money, effort, and scientific talent. They have quietly kept the weapons in storage and haven't even found much benefit in rattling them from time to time. If the recent efforts to keep Iran from obtaining nuclear weapons have been successful, those efforts have done Iran a favor.

There has never been a militarily compelling reason to use nuclear weapons, particularly because it has not been possible to identify suitable targets—or targets that couldn't be attacked as effectively by conventional munitions. Conceivably, conditions exist under which nuclear weapons could serve a deterrent function, but there is little reason to suspect that they have been necessary to deter war thus far, even during the Cold War. The main Cold War contestants have never believed that a repetition of World War II, whether embellished by nuclear weapons or not, is remotely in their interests.

Moreover, the weapons have not proved to be crucial status symbols. How much more status would Japan have if it possessed nuclear weapons? Would anybody pay a great deal more attention to Britain or France if their arsenals held 5,000 nuclear weapons, or much less if they had none? Did China need nuclear weapons to impress the world with its economic growth or its Olympics?

Those considerations help explain why alarmists have been wrong for decades about the pace of nuclear proliferation. Most famously, in the 1960s, President John Kennedy anticipated that in another decade "fifteen or twenty or twenty-five nations may have these weapons." Yet, of the dozens of technologically capable countries that have considered obtaining nuclear arsenals, very few have done so. Insofar as most leaders of most countries (even rogue ones) have considered acquiring the weapons, they have come to appreciate several drawbacks of doing so: nuclear weapons are dangerous, costly, and likely to rile the neighbors. Moreover, as the University of Southern California's Jacques Hymans has demonstrated, the weapons have also been exceedingly difficult for administratively dysfunctional countries to obtain—it took decades for North Korea and Pakistan to do so. In consequence, alarmist predictions about proliferation

chains, cascades, dominoes, waves, avalanches, epidemics, and points of no return have proved faulty.

Although proliferation has so far had little consequence, that is not because the only countries to get nuclear weapons have had rational leaders. Large, important countries that acquired the bomb were run at the time by unchallenged—perhaps certifiably deranged—monsters. Consider Joseph Stalin, who, in 1949, was planning to change the climate of the Soviet Union by planting a lot of trees, and Mao Zedong, who, in 1964, had just carried out a bizarre social experiment that resulted in an artificial famine in which tens of millions of Chinese perished.

Some also fear that a country might use its nuclear weapons to "dominate" its area. That argument was used with dramatic urgency before 2003 when Saddam Hussein supposedly posed great danger, and it has been frequently applied to Iran. Exactly how that domination is to be carried out is never made clear. The notion, apparently, is this: should an atomic rogue state rattle the occasional rocket, other countries in the area, suitably intimidated, would bow to its demands. Far more likely, threatened states would make common cause with each other and with other concerned countries (including nuclear ones) against the threatening neighbor. That is how countries coalesced into an alliance of convenience to oppose Iraq's region-threatening invasion of Kuwait in 1990.

Yet another concern has been that the weapons will go off, by accident or miscalculation, devastating the planet in the process: the weapons exist in the thousands, sooner or later one or more of them will inevitably go off. But those prognostications have now failed to deliver for 70 years. That time period suggests something more than luck is operating. Moreover, the notion that if one nuclear weapon goes off in one place, the world will necessarily be plunged into thermonuclear cataclysm should remain in the domain of Hollywood scriptwriters.

Also keep in mind that anti-proliferation efforts can be counterproductive in their own terms. Thus, "one of the unintended `demonstration' effects of the American anti-proliferation war against Iraq," notes Mitchell Reiss, an expert on nuclear proliferation, "was that chemical and biological weapons proved insufficient to deter America: only nuclear weapons, it appeared, could do this job." North Korea has apparently learned this lesson. Insofar as nuclear proliferation is a response to perceived threat, one way to reduce the nuclear pace is simple: stop threatening countries that might consider acquiring them.

The impulse to prevent nuclear proliferation through any means available should be weighed against the potentially very high costs of counter-

proliferation wars. The war in Iraq, with well over a hundred thousand deaths, is a key case in point. The war against Saddam Hussein was a militarized counter-proliferation effort substantially sold as necessary to keep his pathetic regime from developing nuclear and other presumably threatening weapons, and to prevent him from transferring some of them to eager and congenial terrorists. Karl Rove, President George W. Bush's top political adviser, reflected in 2008 that, absent this belief, "I suspect that the administration's course of action would have been to work to find more creative ways to constrain him like in the '90s."

Nuclear Terrorism

The possibility that small groups could set off nuclear weapons is an alarm that has been raised repeatedly over the decades. However, terrorist groups thus far seem to have exhibited only limited desire and even less progress in going atomic. Perhaps, after a brief exploration of the possible routes, they have discovered that the tremendous effort required is scarcely likely to succeed.

One route a would-be atomic terrorist might take would be to receive or buy a bomb from a generous, like-minded nuclear state for delivery abroad. That route, however, is highly improbable. The risk would be too great—even for a country led by extremists—that the source of the weapon would ultimately be discovered. Here, the rapidly developing science (and art) of "nuclear forensics"—connecting nuclear materials to their sources even after a bomb has been detonated—provides an important deterrent. Moreover, the weapon could explode in a manner or on a target the donor would not approve—including, potentially, the donor itself. Almost no one, for example, is likely to trust al Qaeda: its explicit enemies list includes all Middle Eastern regimes, as well as the governments of Afghanistan, India, Pakistan, and Russia. And the Islamic State, or ISIS, which burst onto the international scene in 2014, has alienated just about every state on the planet.

Nuclear-armed states are unlikely to give or sell their precious weapons to nonstate actors. Some observers, though, worry about "loose nukes," especially in post-Communist Russia—meaning weapons, "suitcase bombs" in particular, that can be stolen or bought illicitly. However, as a former director at the Los Alamos National Laboratory notes, "Regardless of what is reported in the news, all nuclear nations take the security of their weapons very seriously." Careful assessments have concluded that it is unlikely that any nuclear devices have been lost and that, regardless,

their effectiveness would be very low or even nonexistent because nuclear weapons require continual maintenance.

Moreover, finished bombs are outfitted with devices designed to trigger a nonnuclear explosion that will destroy the bomb if it is tampered with. Bombs can also be kept disassembled with the component parts stored in separate high-security vaults (a common practice in Pakistan). Two or more people and multiple codes may be required not only to use the bomb, but also to store, maintain, and deploy it.

There could be dangers in the chaos that would emerge if a nuclear state were to fail, collapsing in full disarray. However, even under those conditions, nuclear weapons would still have locks or be disassembled and would likely remain under heavy guard by people who know that a purloined bomb would most likely end up going off in their own territory.

Most analysts believe that a terrorist group's most promising route would be to attempt to make a bomb using purloined fissile material—plutonium or highly enriched uranium. However, as the Gilmore Commission—the advisory panel on terrorism and weapons of mass destruction—stressed, building and deploying a nuclear device presents "Herculean challenges." The process requires a lengthy sequence of steps; if each is not fully met, the result is not simply a less powerful weapon, but one that can't produce any significant nuclear yield at all or can't be delivered.

First, the terrorists would need to steal or illicitly purchase the crucial plutonium or highly enriched uranium. This would most likely require the corruption of a host of greedy confederates, including brokers and money transmitters, any one of whom could turn on the terrorists or, out of either guile or incompetence, furnish them with material that is useless. Any theft would also likely trigger an intense international policing effort.

Second, to manufacture a bomb, the terrorists would need to set up a large and well-equipped machine shop and populate it with a team of highly skilled and extremely devoted scientists, technicians, machinists, and managers. These people would have to be assembled and retained for the monumental task while generating no consequential suspicions among friends, family, or police about their sudden and lengthy absence from normal pursuits back home. Throughout, the process of fabricating a nuclear weapon would require that international and local security services be kept perpetually in the dark, and that no curious locals, including criminal gangs, get wind of the project as they observe the constant coming and going of outside technicians over the months or even years it would take to pull off.

Physicists who have studied the issue conclude that fabricating a nuclear weapon "could hardly be accomplished by a subnational group" because of "the difficulty of acquiring the necessary expertise, the technical requirements (which in several fields verge on the unfeasible), the lack of available materials and the lack of experience in working with these." Others stress the "daunting problems associated with material purity, machining, and a host of other issues," and conclude that the notion that a terrorist group could fabricate an atomic bomb or device "is far-fetched at best."

Finally, the resulting weapon, likely weighing a ton or more, would have to be moved to a target site in a manner that did not arouse suspicion. Then a skilled crew would have to set off the improvised and untested nuclear device, hoping that the machine shop work has been perfect, that there were no significant shakeups in the treacherous process of transportation, and that the device, after all the effort, isn't a dud.

The financial costs of such an extensive operation could easily become monumental: expensive equipment to buy, smuggle, and set up and people to pay—or pay off. Any criminals competent and capable enough to be effective allies in the project would likely discover boundless opportunities for extortion and be psychologically equipped by their profession to exploit them.

Khalid Sheikh Mohammed, the designated "mastermind" behind the 9/11 attacks, reportedly said that al Qaeda's atom bomb efforts never went beyond searching the Internet. Even so, that raises the popular notion that the Internet can be effective in providing operational information. However, that belief seems to be severely flawed. Researcher Anne Stenersen finds that the Internet is filled with misinformation and error and with materials hastily assembled and "randomly put together," containing information that is often "far-fetched" or "utter nonsense."

Some members of al Qaeda may have dreamed about getting nuclear weapons. The only terrorist group to actually indulge in such dreams has been the Japanese millennial group Aum Shinrikyo. However, its experience can scarcely be much of an inspiration to other terrorist groups. Aum Shinrikyo was not under siege or even under close watch, and it had some 300 scientists in its employ, an estimated budget of $1 billion, and a remote and secluded haven in which to set up shop. After making dozens of mistakes in judgment, planning, and execution in a quest for nuclear weapons, it abandoned its efforts.

The rise of ISIS in 2014 does not alter these conclusions. The vicious group is certainly a danger to the people under its control and to fellow

Muslims and neighboring Christians. It is actually more visible—that is, easier to find—than al Qaeda in that it seeks to hold and govern physical territory, a task that is increasingly difficult in a hostile world. In the process, it is unlikely to be able to amass the finances, the skills, and the serenity to go atomic.

The notion that terrorists could come up with a nuclear weapon seems remote. As with nuclear proliferation to countries, there may be reason for concern, or at least for interest and watchfulness. But alarm and hysteria are hardly called for.

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—Prepared by John Mueller

77. Public Opinion on U.S. Foreign Policy

Policymakers should

- understand that their support for intervention obscures the existence of a strong restraint-minded constituency in the United States;
- know that fears about terrorism and humanitarian concerns remain pertinent for restraint-minded policymakers; and
- focus on effective issue framing to help build support for a more restrained foreign policy.

Since the end of the Cold War, a strong bipartisan consensus has emerged in favor of frequent American military intervention. Even President Obama, who came into office calling for greater restraint than his predecessor, expanded the "war on terror," engaged in regime change in Libya, and decided against withdrawing U.S. troops from Afghanistan. Facing vocal critics who seek to increase American intervention not just in the Middle East but also in conflicts throughout the world, President Obama was unable to implement many of the more restrained policies he advocated.

Given this environment, the next president should know that there is a significant "restraint constituency" among Americans, despite the interventionist tendencies found on both right and left. This constituency—which cuts across party lines and represents roughly 37 percent of the public—exhibits a reliable disposition toward foreign policy restraint, opposing the use of military force in all but a few cases. That constituency contrasts with an "interventionist constituency," which represents about a quarter of the public and supports much more aggressive efforts to promote American interests abroad. Since neither constituency's core fol-

lowers represent a majority, the deciding voice between intervention and restraint in foreign policy debates belongs to the 40 percent of the public that falls somewhere between the two camps.

Though the restraint constituency enjoys an advantage on many important foreign policy issues, public fears about terrorism and other global conflicts will continue to be a significant challenge for restraint-minded policymakers. Framing world events as "other people's business," reminding the public of the costs of major war, and pursuing an active noninterventionist counterterrorism strategy can help policymakers encourage public support for a more restrained foreign policy.

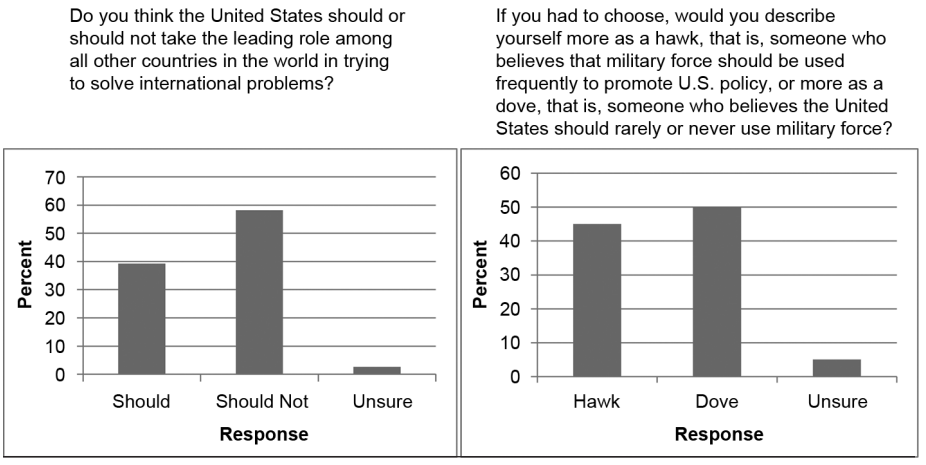
A Restraint Constituency

In the broadest sense most Americans agree that the United States should play some sort of role in world affairs. The best-known poll question on this topic asks whether the United States should "take an active part" in or "stay out" of world affairs. The proportion of respondents who say "take an active part" has ranged between 60 percent and 70 percent since the mid-1980s. What such surveys do not communicate clearly, however, is what exactly people mean when they answer them. In the case of military intervention, taking an "active part" could mean anything from contributing to a peacekeeping mission to supporting frequent full-scale regime change of a hostile regime, while "stay out" could mean anything from cutting ties with allies to rejecting responsibility for resolving foreign conflicts.

We can develop a more complete picture by assessing people's beliefs on two key fundamental questions regarding intervention and the use of force. The first question concerns how much effort the United States should make to solve the world's problems. The second concerns how often the United States should turn to military force to promote national interests. Figure 77.1 provides a snapshot of Americans' underlying attitudes along these two dimensions.

With these answers in hand we can begin to identify competing predispositions toward foreign policy. Some Americans—those labeled here the restraint constituency—feel that the United States should not seek to take the leading role among all nations to solve the world's problems and believe that the United States should rarely use military force. Those who answer the opposite—labeled here the interventionist constituency—believe the United States should take the leading role and support the frequent use of military force to promote American interests. Figure 77.2

Figure 77.1
Foundations of Restraint



SOURCE: CNN/ORC Poll, "Terrorism/ISIS," September 25–28, 2014.

combines responses to both questions, helping identify and measure four distinct postures toward foreign affairs.

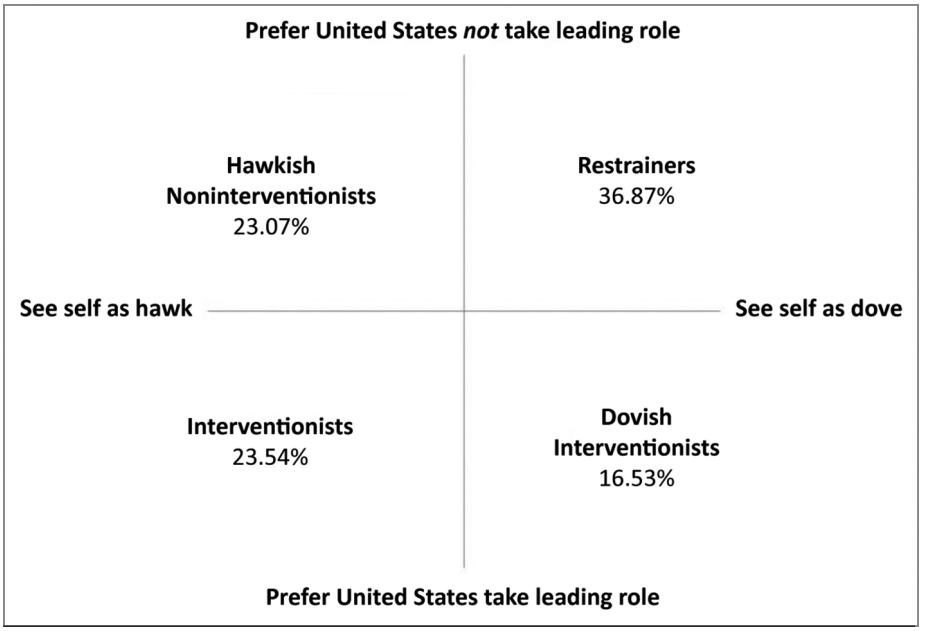
The American public is divided over the fundamental questions facing the nation regarding foreign policy. The restraint constituency is the largest single bloc at around 37 percent, while the interventionist constituency comprises a smaller but still significant 24 percent. The remainder of the population holds views that are neither consistently restrained nor consistently interventionist.

These predispositions toward restraint and intervention are just that—under certain conditions, even restrainers will support intervention and interventionists will not. At any particular moment, Americans' opinions reflect not only these predispositions but also information coming from political leaders and the news media about the world. More recent polling on the Islamic State in Iraq and Syria (ISIS), for example, illustrates that support for an aggressive response has risen considerably across all groups as concerns about the threat posed by ISIS have grown.

The Politics of Restraint Today

The shifting context of international security and domestic politics provides both opportunities and challenges to policymakers trying to chart a restrained path in foreign policy.

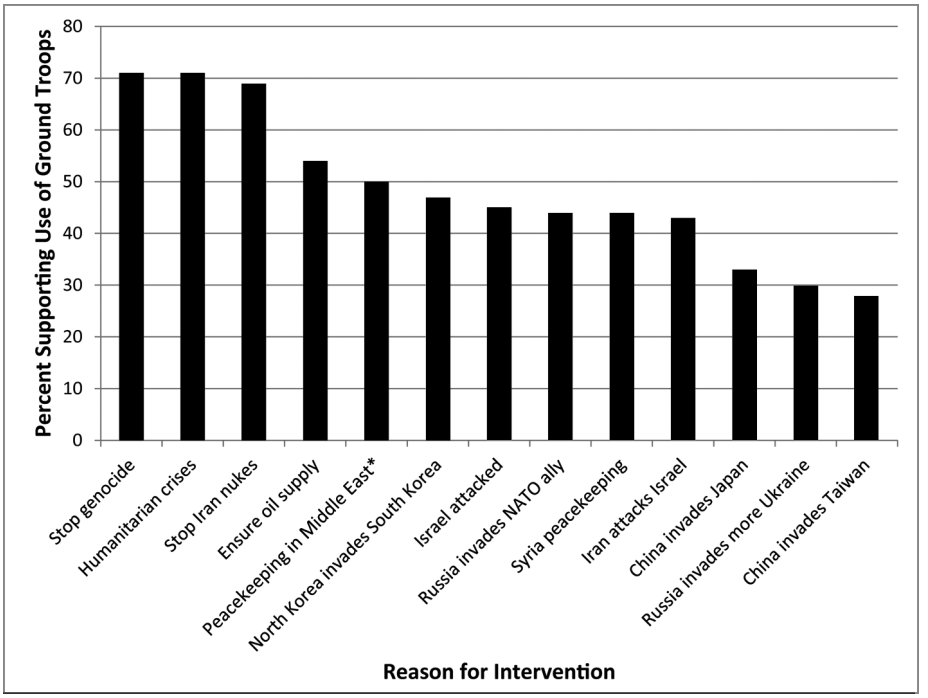
Figure 77.2
The Restraint Matrix



SOURCE: CNN/ORC Poll, "Terrorism/ISIS," September 25–28, 2014.

Today, three major factors work in favor of restraint. The first is war fatigue. Large majorities remain convinced that both the wars in Afghanistan and Iraq were mistakes. With over 7,000 U.S. military personnel killed and tens of thousands more wounded, and trillions of dollars spent killing terrorists and "exerting influence" in the Middle East and elsewhere, many Americans are simply convinced it is time to focus more on domestic concerns. Along these lines, a 2016 Pew survey found that 70 percent of the public wants the next president to focus on domestic issues compared with just 17 percent who want to see a focus on foreign policy. One possible interpretation of this finding is that a growing number of Americans see little connection between military intervention and American security, especially given how few terrorist attacks have occurred on American soil since 9/11. As a result, fewer may now believe such efforts are worth the high costs in lives and money and the lack of attention paid to domestic issues. Such poll findings establish a high burden of proof for future intervention. Those seeking to repeat a troop-intensive intervention in the Middle East will have to not only explain why the security risk justifies

Figure 77.3
What Issues Justify Military Intervention?



NOTE: NATO = North Atlantic Treaty Organization; *Original survey question = "To be part of an international peacekeeping force to enforce a peace agreement between Israel and the Palestinians."
SOURCE: Smeltz, Dina, and Ivo Daalder. *Foreign Policy in the Age of Retrenchment: Results of the 2014 Chicago Council Survey of American Public Opinion and US Foreign Policy.* Chicago Council on Global Affairs, 2014.

such an action but also reassure the public that the next ISIS will not emerge in its aftermath.

Second, the American public continues to find serious military intervention justified in relatively few situations. As Figure 77.3 shows, a majority of the public opposes most potential uses of U.S. ground troops, with two key exceptions: humanitarian intervention (including preventing genocide) and preventing Iran from developing nuclear weapons. Taken together, those two factors suggest that a president advocating a restraint-based foreign policy is likely to enjoy substantial popular support.

At the same time, however, the emergence of ISIS clearly represents a significant challenge to a restraint-minded president. The group's barba-

Table 77.1
Support for Counterterrorism Intervention (Percent)

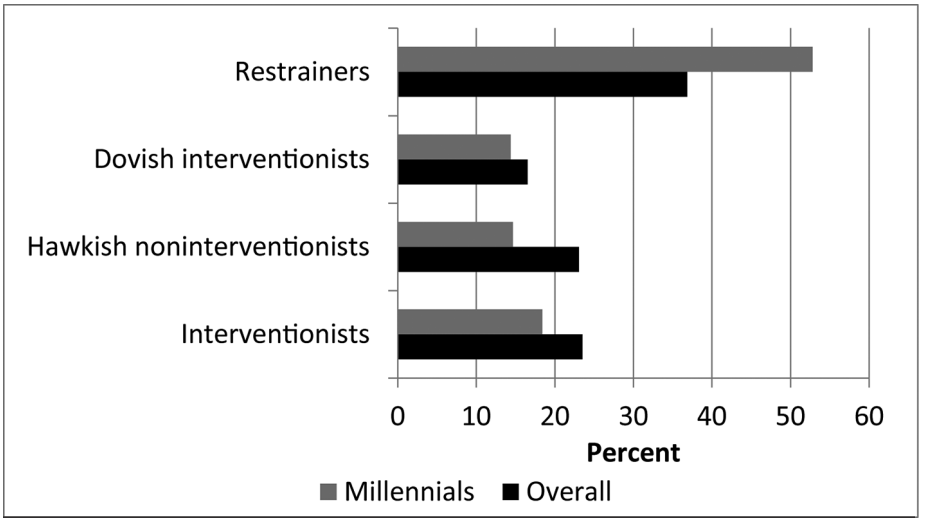
Policy	Democrats	Independents	Republicans	Overall
U.S. air strikes against terrorist training camps and other facilities	78	73	85	77
Use of drone strikes to assassinate individual terrorist leaders	77	71	86	76
Assassination of individual terrorist leaders	74	68	83	73
Attacks by U.S. ground troops against terrorist training camps and other facilities	55	55	73	60
Military assistance to Arab governments to combat violent Islamic extremist groups	59	55	64	58
Retention of some U.S. troops in Afghanistan beyond 2016 for training and counterterrorism	51	49	68	54

SOURCE: Smeltz, Dina, and Ivo Daalder. *Foreign Policy in the Age of Retrenchment: Results of the 2014 Chicago Council Survey of American Public Opinion and US Foreign Policy.* Chicago Council on Global Affairs, 2014.

rism and military success, along with the attacks in Paris and San Bernardino, have driven public support for an aggressive response to levels not seen since the early days after 9/11. Drawing on the Chicago Council on Global Affairs 2015 survey, Table 77.1 reveals public support across party lines for a host of counterterrorism activities.

Finally, looking beyond the temporary effects of global events, the situation today reflects generational shifts in public opinion. The data reveal that the restraint constituency has been growing as younger and less intervention-minded Americans start to replace older, more interventionist Americans. The millennial generation, born between 1980 and 1997, is the most restrained yet, with both Democratic and Republican millennials more likely to fall into the restraint constituency. Figure 77.4 illustrates the generational shift toward restraint.

Figure 77.4
Millennials: Generation Restraint



SOURCE: CNN/ORC poll, September 11–14, 2014.

The Road Ahead: Priming the Restraint Constituency

Continued clashes between the restraint and interventionist constituencies are inevitable. Both camps can rely on a core of followers to support their positions, and both have illustrated the ability—on different issues—to command majority support. Thus, the key questions are these: Under what conditions will the restraint constituency win the day? And how can policymakers help make that happen? Restraint-minded policymakers can make the strongest case possible in various ways.

Most important, policymakers should assert a "civil conflict" frame when discussing the situation in places like Syria, Iraq, Afghanistan, and any future failed or troubled state. Historically, the restraint position has been most compelling when Americans believe they are being asked to intervene to resolve other nations' internal problems, while interventionist arguments have been strongest when Americans are asked to take action against a group or nation that poses a direct threat to the United States. In reality, of course, public perception often depends in large part on how the president, other political leaders, and the media frame the issue in the first place.

The Syrian civil war provides an excellent illustration of this dynamic. In 2013, the popular perception was that, although tragic, the situation

was above all a civil war and primarily Syria's problem. As a result, 68 percent of the public told pollsters that the United States did not bear responsibility for Syria, and a similar majority opposed sending troops or even providing aid to the rebels fighting Assad. Yet by 2015, a large percentage of the public saw Syria not as a civil war but as a battlefield on which to confront the threat of terrorism, largely because of the attacks in Paris and San Bernardino.

Restraint-minded policymakers should also invoke the length and cost of the wars in Afghanistan and Iraq, along with the chaos that both created, including the birth of ISIS. Even as Americans indicate a desire to move more aggressively against ISIS, they remain extremely wary of a full-scale ground war. To the extent that political leaders can keep the public focused on the dangers of any military engagement, they can reduce the appeal of calls for more intervention.

Finally, policymakers, especially the president, should emphasize noninterventionist strategies for counterterrorism. It is clear that the fear of terrorism is the most likely cause of future American intervention abroad in the near to medium term. And though nothing can completely eliminate calls from the interventionist constituency to play whack-a-mole abroad to combat terrorist groups, the majority of the public traditionally prefers exploring nonmilitary means of solving problems over the use of force. If policymakers highlight an active program of nonmilitary counterterrorism efforts, calls for military intervention are not likely to garner public support.

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—Prepared by A. Trevor Thrall

78. U.S. Policy toward Latin America

Policymakers should

- facilitate dollarization for any country that wishes to adopt the dollar as its national currency;
- merge all hemispheric trade agreements into a single Free Trade Area of the Americas;
- end the Alliance for Prosperity in the Northern Triangle of Central America; and
- end the hemispheric war on drugs.

For the past 15 years, Latin America has grown more confident and assertive. Buoyed by decent growth rates, marked declines in poverty and inequality, and the rise of a new middle class, the days when Washington exerted an overbearing influence in the region seem long gone. This phenomenon was compounded by the ascendancy in several countries of left-wing governments which, to various degrees, distanced themselves, or openly antagonized, the United States.

However, Latin America is now entering a period of low growth, largely because of the fall in the price of commodities, which could imperil some of its socioeconomic gains. That environment creates an opportunity for Washington to positively influence economic policy in Latin America in limited but important ways.

From 2001 to 2015, economic growth in Latin America averaged 3.8 percent per annum. That is not a stellar rate, particularly when compared with the Asian "tigers" in the 1980s and 1990s. But it is a welcome departure from previous decades that saw stagnation and economic crises. More than 70 million people have escaped poverty since the turn of this century. Panama (6.5 percent) and Peru (5.3 percent) are the economies with the fastest growth rate in this century, while El Salvador (1.9 percent)

and Mexico (2.1 percent) are the lowest. Those numbers show that, despite some regional trends, there are significant differences in how Latin American economies have performed.

The 21st century started with Latin America mired in yet another economic downturn. Mexico's economy went into a mild recession. Brazil was still reeling from its currency crisis of 1997–98. Argentina defaulted on its debt and suffered its worst economic contraction in decades, with its ensuing contagion in Uruguay—which was bailed out by Washington. But the region's misfortunes soon reversed. The structural reforms of the 1990s, commonly identified with the Washington Consensus, laid the groundwork for macroeconomic stability in the 2000s. In particular, low levels of inflation and, to some degree, sound government finances were the norm in most countries.

The Commodities Boom

For much of Latin America, the leading driver of economic growth for nearly a decade was the favorable global headwinds of high commodity prices. According to Ernesto Talvi and Ignacio Muyo of the Brookings Institution, from 2003 to 2008, the average price of commodities increased by 75 percent compared with the previous five-year period. After a brief crash during the financial crisis, prices recovered and remained high until mid-June 2014. The economies of most South American countries benefited tremendously, propped up by the export of oil, copper, gas, iron ore, soy, and other raw materials. As a result, governments profited handsomely too, either by imposing windfall taxes on extracting industries or by exploiting natural resources themselves through state-owned enterprises.

This bonanza had a two-pronged effect on the economic policies of the region. First, it encouraged complacency, which meant that, with few exceptions, meaningful liberalizing measures were largely absent. Second, it empowered populist regimes in several countries; those governments not only reversed previous reforms, but also went further down the road of implementing what they called "Socialism of the 21st century." Venezuela is the most emblematic case.

In fairness, some gains from the previous decade were consolidated in the 2000s. Perhaps the most important has been the control of inflation. According to Steve Hanke of Johns Hopkins University, Latin America witnessed seven episodes of hyperinflation from the 1970s through the 1990s. Runaway inflation has been a scourge for most countries in the region, contributing to stubbornly high levels of poverty and inequality,

as well as economic instability. However, reforms granting independence to central banks—along with other measures such as liberalizing exchange rate regimes and opening up capital markets—put a lid on inflation. Between 2000 and 2013, the median inflation rate in Latin America was 6.4 percent.

Similarly, many countries pursued trade liberalization since the turn of the century. There has been a proliferation of trade agreements within the region and also between Latin American countries and the United States, the European Union, Canada, and China, among others. Following the implementation of the North American Free Trade Agreement (NAFTA) in 1995, Washington negotiated deals with Chile (2004), the Central American nations and the Dominican Republic (2006–2009), Peru (2009), Panama (2012), and Colombia (2012). What most of these agreements have done in the short term is to consolidate the market access that already existed when they were first negotiated and to set common standards on rules of origin and nontariff regulations. Meaningful market openness will take place in the ensuing decade as the lengthy periods of tariff phaseouts are completed.

The exception to the slow-motion approach to trade liberalization is the Pacific Alliance, a promising bloc made up of Colombia, Chile, Mexico and Peru, whose goal is to abolish all the barriers to the free movement of goods, services, capital, and people among its member states. The protocol that eliminates tariffs on 92 percent of the products traded within the bloc went into effect on May 1, 2016, and it stipulates that the remaining 8 percent will be phased out by 2030. Several Latin American countries have expressed interest in joining the bloc as full members; but unlike other regional groupings that pay lip service to economic integration, the Pacific Alliance is requiring firm commitments to freer movement of goods and people and only admits as members those nations that agree to fully comply with its ambitious goals.

The "Pink Tide"

The advent of the Pacific Alliance exposed an ideological—and nearly geographical—regional divide between those countries that based their economic and political models on open markets and the strengthening of democratic institutions—largely found on the continent's Pacific rim—and those that opted for populism and strong government intervention in the economy.

The rise of the so-called "Pink Tide"—populist, left-wing governments that came to power primarily in the 2000s—requires a more nuanced

analysis since there have been different shades of pink—or red. Venezuela and its closest allies—Bolivia, Ecuador, and Nicaragua—are the most radical regimes since they openly promote their slogan of "Socialism of the 21st century." Their leaders employed a premeditated strategy of using democratic means to achieve power only to dismantle democratic institutions—such as the separation of powers, free press, a nonpolitical military—from within. Along with Cuba and other small island nations in the Caribbean, they founded the Bolivarian Alliance for the Peoples of Our America (ALBA), as a counterweight to the aborted Washington-led Free Trade Area of the Americas (FTAA).

Despite similarities in the mechanisms that ALBA governments employed to subvert democracy in their countries, there are wide disparities in their economic policies. Venezuela has pursued the most aggressive socialist agenda—nationalizing hundreds of industries and farms, imposing rigid exchange and price controls, dramatically expanding public spending, and debasing the national currency—but its allies have not been able or willing to follow the same path. For example, the economy is dollarized in Ecuador, which has prevented the government from inflating the currency and has somewhat limited its ability to increase public spending recklessly. Bolivia nationalized energy companies, public utilities, and airports but has maintained a prudent monetary policy with low inflation levels and the world's largest foreign exchange reserves as a proportion of gross domestic product. Nicaragua is the most puzzling case of the ALBA: although its government espouses the group's socialist rhetoric, it has a free trade agreement with the United States and one of the region's most orthodox economic policies; as evidence, the International Monetary Fund recently closed its office in Managua because of "Nicaragua's success in maintaining macroeconomic stability and growth."

Venezuela is the flagship populist regime in Latin America. During the course of a decade and a half, the government received nearly $1 trillion in oil revenues. That was enough to mask the effect of hundreds of expropriations, burdensome economic controls, and, in general, the government's seeming determination to run the private economy into the ground. However, even when oil prices were hovering above $100 per barrel, the government's finances went increasingly into the red. The external debt has gone up by 115 percent in the past decade, and inflation is out of control: according to official figures, year-on-year inflation reached 487.6 percent in June 2016. Behind the macroeconomic figures is a deepening humanitarian crisis. The government lacks the dollars to pay

for imports that, compounded with price and capital controls, have caused widespread shortages of food and medicines. Socialism has turned Venezuela into a basket case. The silver lining is the demonstration effect that this chaos has had for the rest of Latin America about the perils of populism, a lesson reinforced by the absence of U.S. intervention, which so often proves counterproductive.

Outside the ALBA, the Pink Tide has consisted of mainly moderate social democratic governments that took advantage of the commodity boom to increase public spending while respecting democratic institutions. There are exceptions. In Argentina, the left-wing administrations of the late Nestor Kirchner and his successor—and wife—Cristina Fernández, became increasingly authoritarian as they implemented policies similar to those of Venezuela, such as nationalizations, currency and exchange controls, and unsustainable levels of public spending financed by inflation. By the time Fernández left power in December 2015, Argentina was the country that followed Venezuela's economic policies most closely.

Brazil's left-wing governments under the Workers' Party were seen for several years as a model of moderate politics and sensible social policies. Brazil's economy grew decently during most of the last decade and, as a result, witnessed significant reductions in poverty. However, the fall in the price of commodities exposed many of the country's shortcomings, such as a bloated bureaucracy, high and complex taxes, and stifling business regulations. Those shortcomings, along with the mismanagement of the economy by President Dilma Rousseff, brought Brazil to its worst recession since the 1930s. Adding to the country's economic misfortunes, a massive corruption scandal involving the state-owned oil company Petrobras has rattled the political class and led to the impeachment of Rousseff. A new government led by her former deputy, Michel Temer, promises much-needed economic reforms, but it remains to be seen whether he can deliver them given the tumultuous political environment.

A worrying development is taking place in Chile, a country that became Latin America's wealthiest and most successful society thanks to its free-market model. After the return of democracy in 1990, successive left-of-center governments deepened the reforms that were initially introduced during the years of the military dictatorship. But that changed with the second term of Michelle Bachelet beginning in 2014 and her efforts to undermine Chile's successful economic policies with higher taxes, heavier regulations, and new entitlements such as free higher education. Her government is even proposing a new constitution whose stated aim is to

replace the country's free-market model with a Scandinavian-inspired welfare state. Chile is a stark reminder that the siren song of populism can have an effect even in countries with a successful economic and social record.

A Positive Role for U.S. Policy in Latin America

Despite Latin America's newfound assertiveness, there are several areas where Washington can still exert a positive influence, either by facilitating economic reforms or by discontinuing programs that have a negative impact in the region.

Dollarization

As the example of Ecuador shows, dollarization facilitates macroeconomic stability even when a country has a populist government. In Latin America, El Salvador and Panama also use the U.S. dollar as their national currency. Since currency volatility is still a problem in many countries, and the use of the dollar is widespread in the region, it is possible that other nations may wish to replace their currencies with the dollar as well. The United States should neither discourage nor encourage those moves but should facilitate official dollarization where it occurs. That may mean sharing the dollar's seigniorage—the profit that derives from printing currency—with countries that decide to dollarize. In that way, the United States would neither gain nor lose money as a result of another country's decision to dollarize, but the dollarizing country might more easily dollarize if it could still earn seigniorage from the currency it uses.

Dollarization alone cannot solve a country's economic problems. But for countries with poor monetary policies, dollarization would end currency risk, reduce interest rates, and help stimulate investment and growth.

Free Trade Area of Most of the Americas

The idea of creating a hemisphere-wide free trade area that stretches from Alaska to Patagonia has been dead since Argentina, Brazil, and Venezuela killed it in 2005. Some experts say that calls for expanded trade with Latin America are not realistic since Washington already has deals with all the Latin American countries that want trade agreements with the United States; those that do not, such as Brazil and Argentina, are not interested in one. However, that does not mean there is no room for a substantial hemispheric trade agenda. The countries Washington has free trade agreements with in the Americas also have similar deals among

themselves. There are some missing links, but overall, these countries have created a fragmented version of a free trade area of the Americas.

One obvious problem with the current situation is what Columbia University economist Jagdish Bhagwati has called the "spaghetti bowl effect" of so many trade agreements with different rules of origin, tariff schedules, and nontariff regulations. The United States should lead an effort to merge all the regional free trade agreements into a single Free Trade Area of the Americas for the nations willing to be part of it. The negotiations could also help to complete those missing links in the hemispheric trade jigsaw puzzle. The FTAA would leave the door open for other Latin American countries that might want to join in the future. Uruguay and Paraguay are the most likely candidates given their growing dissatisfaction with their membership in the protectionist Southern Common Market (Mercosur), which also includes Argentina, Brazil, and Venezuela.

End the Alliance for Prosperity

The United States should discontinue the Alliance for Prosperity in the Northern Triangle Plan, a conditional program that began in 2016 and whose purpose is to give El Salvador, Guatemala, and Honduras $750 million in extra aid to help them fight poverty and crime. These Central American countries suffer from some of the most acute economic and security challenges in the Americas, some of which Washington has played a significant role in causing through the war on drugs. However, throwing money to governments with serious institutional flaws will not solve these problems—and may exacerbate them. After all, for almost a decade, both El Salvador and Honduras have received hundreds of millions of dollars in U.S. aid from the Millennium Challenge Corporation for supposedly meeting thresholds in fighting corruption and improving governance. During this period, the grades of both countries on the Rule of Law dimension in the World Bank's "Worldwide Governance Indicators" actually deteriorated. This shows that despite the conditionality guarantees included in the Alliance for Prosperity, Washington has a well-documented record of disregarding the evidence of whether it is accomplishing its goals or being counterproductive.

End the Hemispheric War on Drugs

Washington must end its destructive war on drugs in the region, which works at cross-purposes with important U.S. policy priorities (see Chapter

75). In drug-source and -transit countries such as Colombia, Mexico, and the Central American and Caribbean nations, the drug war is fueling corruption and violence, undermining the rule of law, and otherwise debilitating the institutions of civil society. According to the 2013 Global Study on Homicide by the United Nations, 8 of the 10 countries with the highest murder rate in the world are located in the cocaine route that goes from the Andes to the United States. Drug violence in Mexico has killed over 100,000 people since 2006. The effect of the U.S.-led war on drugs south of the border has been imperceptible in the United States, but its consequences in Latin America are completely at odds with Washington's stated goal of encouraging free markets and civil society.

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—Prepared by Juan Carlos Hidalgo

79. U.S. Policy toward Sub-Saharan Africa

Congress should

- expand the Africa Growth and Opportunity Act by granting tariff- and quota-free access to all imports from sub-Saharan Africa;
- end U.S. farm subsidies that undermine African producers and keep food prices in the United States unnecessarily high;
- discontinue bilateral aid to African governments, and oppose International Monetary Fund and World Bank lending to the governments in the region;
- discontinue the U.S. Africa Command, which might draw the United States into more conflicts and be viewed by Africans as a neocolonialist venture; and
- impose "smart" sanctions on leaders under strong suspicion of corruption and human rights abuses.

Sub-Saharan Africa (hereafter "Africa") consists of 46 countries and 9.4 million square miles. One billion out of 7 billion people on earth live in Africa. The continent's share of the world's population is bound to increase because Africa's fertility rate remains higher than elsewhere. In 2014, for example, Africa's fertility rate was close to five births per woman. In America, it was close to two births per woman. If current trends continue, there will be more people in Nigeria than in the United States by 2050.

Africa is the world's poorest continent, but it is no longer a "hopeless continent," as *The Economist* described it in 2000. Since the start of the new millennium, average per capita income adjusted for inflation and purchasing power parity rose by more than 50 percent. Africa's growth rate has averaged almost 5 percent per year not only as a result of high commodity prices, but also as a result of better economic policies.

Increasing wealth has led to improvements in key indicators of human well-being. In 1999, 58 percent of Africans lived on less than $1.90 per person per day. By 2011, 44 percent lived on that income—while the population rose from 650 million to 1 billion. If the current trends continue, Africa's absolute poverty rate will fall to 24 percent by 2030.

Life expectancy rose from 54 years in 2000 to 62 years in 2015. Infant mortality declined from 80 deaths per 1,000 live births to 49 deaths over the same time period. When it comes to HIV/AIDS, malaria, and tuberculosis, the occurrence, detection, treatment, and survival rates have all improved. Food supply exceeds 2,500 calories per person per day (the U.S. Department of Agriculture recommends consumption of 1,900 calories for moderately active women and 2,500 calories for moderately active men), and famines have disappeared outside of warzones. Primary, secondary, and tertiary school enrollments have never been higher.

In contrast to previous decades—when much of the continent eschewed globalization, competition, free trade, foreign direct investment, and multinational corporations—an increasing number of African governments appreciate the benefits of participating in a global economy. Since the start of the new millennium, economic freedom has grown and the business environment has improved.

Conversely, there has been no substantial improvement in the quality of Africa's institutions. The quality of the rule of law and the levels of corruption are strikingly similar to what they were in 2000. Similarly, political and civil freedoms have not noticeably improved.

Looking forward, Africa's demographic and economic expansion will present the United States with unique opportunities and challenges. The continent's natural resources will remain important, and its agricultural potential will grow. The rising affluence of the African consumer will make the continent more lucrative to American businesses. Whatever challenges pertaining to Africa's economic and institutional development remain, Americans need to recognize that the ability of the United States to influence Africa's politics and economics is limited. Most of Africa's developmental challenges are caused by domestic factors that require domestic solutions.

Domestic Reforms

Much of Africa's postcolonial history was marked by governments' mismanagement of the economy. African governments long imposed central control over their economies—a development strategy that was not

conducive to economic growth. Inflationary monetary policies; price, wage, and exchange rate controls; marketing boards that kept the prices of agricultural products artificially low and impoverished African farmers; and state-owned enterprises and monopolies were commonplace.

That began to change after the fall of the Berlin Wall. Socialism lost much of its appeal, and the Soviet Union, which bankrolled and protected many African dictatorships, fell apart. Between 1990 and 2013, economic freedom as measured by the Fraser Institute rose from 4.77 out of 10 to 6.29. Freedom to trade rose even more, from 4.21 to 6.43. Africa has also made much progress in terms of monetary policy, or access to sound money, which rose from 5.08 to a remarkable 7.29.

Africa has made similar strides in terms of microeconomic policy. As the World Bank's *Doing Business* report indicates, Africa's regulatory environment is much improved. Starting a business, for example, is much easier than in the past, having risen from a score of 42.5 out of 100 in 2004 to 71.4 in 2015. Construction permitting; resolution of insolvencies; enforcement of contracts; access to electricity; and the ease of paying taxes, registering property, and getting credit have all improved considerably.

As already noted, political reforms have lagged behind economic reforms. According to Freedom House's *Freedom in the World* 2016 report, there were only six free countries in Sub-Saharan Africa: Benin, Botswana, Ghana, Namibia, Senegal, and South Africa. While many countries have adopted more "democratic" constitutions that include term limits and other legislative and institutional checks on the executive branch of government, African rulers have found ways around those provisions to maintain power and abuse it. According to the World Bank, corruption continues to thrive among government officials and, importantly, among members of the judiciary. As a consequence, rule of law indicators for African countries have remained, by and large, unchanged. And without efficient and impartial courts, Africa's economic potential will always remain unfulfilled.

That said, as experience in other regions shows, institutional development tends to lag behind economic reforms. In the medium to long run, the growth of the African middle class might yet result in political awakening and greater assertiveness of the African populace and eventual democratization of the continent.

Free Trade

The United States can help by further opening its markets to African exports. Congress took a step in the right direction by adopting the Africa

Growth and Opportunity Act (AGOA) in 2000. In 2015, AGOA was extended until 2025. Today, 39 African countries remain eligible to export to the United States under the terms of AGOA. In 2013, about 91 percent of U.S. imports from AGOA countries entered the United States duty-free. Combined two-way trade between the United States and AGOA countries doubled between 2001 and 2014, with a peak in 2008 of almost $100 billion. The global financial crisis and declining U.S. reliance on foreign oil have reduced the total amount of trade between the United States and AGOA countries to roughly $50 billion per year, with Africa's trade surplus amounting to some $2 billion.

The benefits of free trade are political and economic. First, free trade can be a potent weapon against terror directed against the United States. Apparel trade with the United States alone has created tens of thousands of jobs in the AGOA countries. By providing opportunities, such increased economic interconnectedness between the world's trouble spots and the United States may help dissuade potential terrorist sympathizers from harming the United States. Second, trade increases specialization, which leads to increasing productivity. Reductions in the cost of production lead to cheaper goods and services, which, in turn, increase the standard of living for Americans and Africans alike.

Unfortunately, Washington limits the economic benefits of AGOA in two specific ways. First, some quotas predate AGOA and were not amended by the legislation. Second, AGOA excludes some agricultural products from duty-free access, including sugar, tobacco, dairy, beef, and processed agricultural goods such as dried garlic, canned peaches, and apricots.

While opening U.S. markets to African goods can help Africa, such a move is not sufficient to bring Africa out of poverty. Africa's tariffs are among the highest in the world. According to the World Bank, the average applied tariff on imports to African countries is over 10 percent. In contrast, the average tariff applied by emerging economies like Chile, Vietnam, and Taiwan is less than 6 percent. For Africa to prosper, African countries will have to cut their own external and internal trade barriers and continue with wide-ranging economic reforms that will enable Africa's private sector to grow.

Agricultural Subsidies

In addition to making AGOA comprehensive and unconditional, the U.S. government should stop subsidizing the American agricultural sector. The 2014 farm bill is expected to cost the U.S. taxpayer $956 billion

between 2014 and 2023. If history is any guide, the cost of farm subsidies will rise. The 2002 farm bill, for example, cost 30 percent more than the expected $451 billion. The 2008 farm bill cost the taxpayer 42 percent more than the projected $641 billion.

Ending U.S. farm subsidies would make some agricultural products exported by African countries more competitive, raising farm incomes and reducing poverty in Africa. According to Oxfam International, for example, some 10 million people in Central and West Africa who rely on the production and sale of cotton lose up to $250 million a year due to Western subsidies. Agricultural subsidies are a waste of taxpayer dollars and morally indefensible with regard to the world's poor. They should be abolished.

Aid and Debt

British economist Peter Bauer once described foreign aid as "taxing poor people in rich countries and passing it on to rich people in poor countries." That is an especially accurate description of aid to Africa. Instead of stimulating private-sector growth, aid has increased the size of government. It has enabled government officials to embezzle large amounts of money and misspend much of it on loss-making projects. Crucially, aid has served as a disincentive to economic and political reforms. Today, most researchers agree that economic growth depends on market-oriented domestic policies, not aid.

Since most African nations gained independence in the 1960s, the region has been one of the largest recipients of aid per capita. Yet the region's growth rate averaged less than 2 percent per year during the final 15 years of the last millennium and has averaged close to 5 percent since the start of the new millennium. The difference in the growth rates then and now is not due to the increased amount of aid, but rather to high commodity prices and domestic reforms.

Considering the negative consequences of aid and the precarious state of American finances, it is surely time to stop transferring financial resources to governments abroad. The sums are not trivial. In 2001, the USAID spent $15 billion on foreign aid globally, with disbursements in Africa amounting to $1.7 billion. In 2014, USAID spent $41 billion globally, with disbursements to Africa amounting to $10 billion. Put another way, in 2001, the USAID spent every ninth dollar in Africa; in 2014, it spent every fourth dollar in Africa.

If Congress insists on spending resources on "African" projects, then developing human capital might deliver greater dividends than giving money to African governments. More African judges and lawyers, for example, might benefit from observing the workings of an efficient and impartial judiciary in the West. Similarly, African businessmen and women might benefit from easier travel to and work in the United States, thereby learning best business and accounting practices. Congress could help build Africa's human capital by relaxing visa and work requirements for Africans and could even offer scholarships and apprenticeships to qualified applicants.

Aside from bilateral aid, Washington also participates in multilateral aid schemes overseen by a variety of international institutions, including the World Bank, the African Development Bank, and the International Monetary Fund (IMF). Those multilateral institutions have often backed unsavory African regimes that have engaged in human rights abuses and gross macroeconomic mismanagement. And although the World Bank's structural adjustment programs and IMF lending were designed to provide credit in exchange for reforms in the region, African compliance with lending conditions has been poor or nonexistent.

The World Bank and IMF do not have the ability to enforce compliance with their loan conditions. Yet both agencies keep lending, and Africa's debt continues to accumulate. Under the Heavily Indebted Poor Countries Initiative, close to 30 African countries received some form of debt relief amounting to tens of billions of dollars. As a consequence, Africa's debt to gross domestic product ratio fell from 66 percent in 2000 to a low of 24 percent in 2008. Since then, the ratio has climbed back up to 36 percent.

Unlike in the past, when African governments borrowed almost exclusively from official creditors, such as the World Bank and the IMF, today Africa owes roughly half of its $250 billion debt to private creditors. This is a step in the right direction because private lenders tend to be more circumspect when lending money to African countries and more insistent that African governments fulfill their commitments to reform and repayment. The discipline that markets impose on historically irresponsible governments would be much enhanced if official aid to Africa ceased.

China

In 2008, *The Economist* published an article bemoaning the supposedly massive Chinese expansion in Africa entitled "The New Colonialists." According to the article, many Western diplomats and politicians worried

about "losing Africa to China." By 2015, *The Economist* published a follow-up story entitled "Not As Easy As It Looks." The article noted that "Western worries about China's burgeoning influence in Africa may be overblown." What happened?

Chinese investment overseas is unusual, because some, perhaps most, of China's foreign direct investment (FDI) is driven by the foreign and domestic policy goals of the Chinese government, not by the commercial objectives of the Chinese private sector. And Chinese investment in Africa ought to be kept in perspective. The stock of Chinese investment in Africa stood at $26 billion in 2013 or 3 percent of total FDI on the continent. British and French firms remain the largest investors in Africa. Even American and South African firms invest more on the African continent than China does.

Moreover, while an estimated 1 million Chinese people have moved to Africa over the last 20 years, the Chinese still constitute a mere 0.1 of people who live on the continent. The combination of the Chinese presence in Africa and Chinese business practices has led to xenophobia and resentment, as well as thousands of anti-Chinese protests on the continent.

Most important, the Chinese have found that doing business in Africa is more difficult than elsewhere. Lack of basic infrastructure (including ports and roads), byzantine bureaucracy, and lack of reliable electric supply have put a stop to many of China's larger ambitions. In the Congo, for example, a deal struck in 2007 to swap $6 billion of Chinese infrastructure funding for profits from copper mining has produced less than $1 billion of investment so far.

AFRICOM

The U.S. Africa Command (AFRICOM) began operations on October 1, 2007. Today, AFRICOM has approximately 2,000 assigned personnel. About 1,500 people work at the command's headquarters in Stuttgart, Germany. Others are assigned to AFRICOM units at MacDill Air Force Base, Florida, and Royal Air Force Molesworth, United Kingdom. In 2015, AFRICOM had a budget of $248 million.

Unlike America's other regional commands, AFRICOM is not intended merely to manage military planning in its area of responsibility. Instead, AFRICOM's mission is to coordinate with other U.S. agencies, such as the USAID, to help African governments establish peace and stability and bring about economic development. AFRICOM's mission assumes not

only that American military officers know the causes of Africa's problems, but that they are able to help Africans to fix those problems.

Originally, AFRICOM was meant to be headquartered in Africa. But things have not gone as planned. Many African nations proved unsuitable to host AFRICOM because of political instability, ongoing civil wars, or large and unfriendly Muslim populations. Other countries saw AFRICOM as a neocolonial adventure necessitated by America's supposed hunger for Africa's natural resources. Nigeria and South Africa, for example, have been vocal in their opposition to the expansion of American military presence in Africa.

Another problem with AFRICOM is the lack of full cooperation from the State Department, which has been reluctant to subordinate U.S. diplomats to the U.S. military. With good reason, the State Department believes that America's African embassies are a better place than military bases in Germany from which to engage with African governments.

AFRICOM's advocates imply that terrorist organizations, such as al Qaeda, would end up running much of Africa were it not for the military training that AFRICOM provides to the African militaries and water wells that it helps dig in African villages. In reality, Africa has, so far, proved to be inhospitable to both foreign state-builders and international terrorists alike.

Thus, AFRICOM has not had real impact on America's security. Moreover, most Americans oppose the United States' acting as the world's policeman. Given that African conflicts pose no compelling threat to the vital national interests of the United States, AFRICOM should be disbanded and American troops should return home.

Smart Sanctions

In the past, the United States has often imposed some form of sanctions to punish the perpetrators of gross human rights violations. However, it is important to recognize that few international sanctions have led to policy changes in targeted countries. To the extent that they helped to end apartheid, the success of sanctions against South Africa appears to be an exception, not the rule.

There are a number of reasons for the limited effectiveness of sanctions. Global agreement on imposition of sanctions is difficult to reach and even more difficult to maintain. Moreover, as sanctions against Saddam Hussein's Iraq showed, all too often it is the poor who suffer, not the ruling elite. Should the United States feel compelled to target those leaders

in Africa who are strongly suspected of corruption and abuses of human rights, it might consider resorting to international arrest warrants, freezing of personal assets abroad, prohibitions on travel, and arms embargos. That said, caution is in order: there is little evidence that such "smart sanctions" will bring about change in government policies or make the lives of the ruling elite more difficult. For example, in spite of "smart sanctions" imposed on him and his cronies by the United States in 2003, Robert Mugabe continues to run Zimbabwe, enjoys shopping and travel overseas, and maintains access to the best international health care. At home, he uses "American sanctions" to stoke up anti-Western sentiments and blame the United States and other Western powers for Zimbabwe's economic problems.

The chief responsibility for the quality of government on the African continent rests with the African people, not with the well-meaning Americans.

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—Prepared by Marian L. Tupy

80. Foreign Aid and Economic Development

Congress should

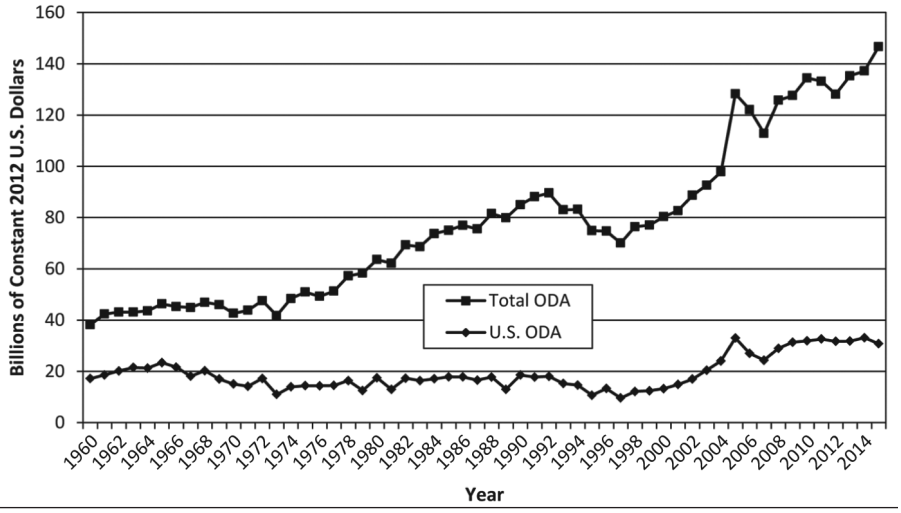
- abolish the U.S. Agency for International Development and end government-to-government aid programs;
- withdraw from the World Bank and regional multilateral development banks;
- not use foreign aid to encourage or reward market reforms in the developing world;
- eliminate programs that provide loans to the private sector in developing countries and oppose schemes that guarantee private-sector investments abroad;
- privatize or abolish the Export-Import Bank, the Overseas Private Investment Corporation, the U.S. Trade and Development Agency, and other sources of international corporate welfare; and
- end government support of microenterprise lending and nongovernmental organizations.

Foreign aid has risen notably since the turn of this century. The United States spends $31 billion in overseas development assistance, and total aid from rich countries is now around $147 billion per year (see Figure 80.1).

Despite that increase in foreign aid, what we know about aid and development provides little reason for enthusiasm:

- There is no correlation between aid and growth.
- Aid that goes into a poor policy environment doesn't work and contributes to debt.
- Aid conditioned on market reforms has failed.

Figure 80.1
Official Development Assistance, 1960–2015



SOURCE: Organization for Economic Co-operation and Development, http://data.oecd.org/oda/net-oda.htm.

- Countries that have adopted market-oriented policies have done so because of factors unrelated to aid.
- There is a strong relationship between economic freedom and growth.

A widespread consensus has formed about those points, even among development experts who have long supported government-to-government aid. The increase in aid reflects a gap between the scholarly consensus on the limits of development assistance and the political push that has made more spending happen.

The Dismal Record of Foreign Aid

By the 1990s, the failure of conventional government-to-government aid schemes had been widely recognized and brought the entire foreign assistance process under scrutiny. For example, a Clinton administration task force conceded that "despite decades of foreign assistance, most of Africa and parts of Latin America, Asia, and the Middle East are economically worse off today than they were 20 years ago." As early as 1989, a bipartisan task force of the House Foreign Affairs Committee concluded that U.S. aid programs "no longer either advance U.S. interests abroad or promote economic development."

Multilateral aid has also played a prominent role in the post–World War II period. The World Bank, to which the United States is the major contributor, was created in 1944 to provide aid mostly for infrastructure projects in countries that could not attract private capital on their own. The World Bank has since expanded its lending functions, as have the regional development banks that have subsequently been created on the World Bank's model and to which the United States contributes: the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, and the European Bank for Reconstruction and Development. The International Monetary Fund (IMF), also established in 1944, long ago abandoned its original role of maintaining exchange-rate stability around the world and has since engaged in long-term lending on concessional terms to most of the same clients as the World Bank.

Despite record levels of lending, the multilateral development banks have not achieved any more success at promoting economic growth than has the U.S. Agency for International Development (USAID). Numerous self-evaluations of World Bank performance over the years, for example, have uncovered high failure rates of bank-financed projects. In 2000, the bipartisan congressional Meltzer Commission found a 55 to 60 percent failure rate of World Bank projects based on the bank's own evaluations. A 1998 World Bank report concluded that aid agencies "saw themselves as being primarily in the business of dishing out money, so it is not surprising that much [aid] went into poorly managed economies—with little result." The report also said that foreign aid had often been "an unmitigated failure." "No one who has seen the evidence on aid effectiveness," commented Oxford University economist Paul Collier in 1997, "can honestly say that aid is currently achieving its objective."

There are several reasons that massive transfers from the developed to the developing world have not led to a corresponding transfer of prosperity. Aid has traditionally been lent to governments, has supported central planning, and has been based on a fundamentally flawed vision of development.

By lending to governments, USAID and the multilateral development agencies supported by Washington have helped expand the state sector at the expense of the private sector in poor countries. U.S. aid to India from 1961 to 1989, for example, amounted to well over $2 billion, almost all of which went to the Indian state. Moreover, much aid goes to autocratic governments.

Foreign aid has thus financed governments, both authoritarian and democratic, whose policies have been the principal cause of their countries' impoverishment. Trade protectionism, byzantine licensing schemes, inflationary monetary policy, price and wage controls, nationalization of industries, exchange-rate controls, state-run agricultural marketing boards, and restrictions on foreign and domestic investment, for example, have all been supported explicitly or implicitly by U.S. foreign aid programs.

Not only has lack of economic freedom kept literally billions of people in poverty, but development planning has thoroughly politicized the economies of developing countries. Centralization of economic decisionmaking in the hands of political authorities has meant that a substantial amount of poor countries' otherwise useful resources has been diverted to unproductive activities, such as rent seeking by private interests or politically motivated spending by the state.

Precisely because aid operates within the (usually deficient) political and institutional environments of recipient countries, even when it goes to countries that don't rely on development planning, it can have detrimental effects. That is all the more true with higher levels of foreign assistance, as has been the case with Sub-Saharan African countries, most of which have received 10 percent or more of their national income in foreign aid for at least three decades. As Nobel laureate in economics Angus Deaton notes, "large inflows of foreign aid change local politics for the worse and undercut the institutions needed to foster long-run growth. Aid also undermines democracy and civic participation, a direct loss over and above the losses that come from undermining economic development."

It has become abundantly clear that, as long as the conditions for economic growth do not exist in developing countries, no amount of foreign aid will be able to produce economic growth. Indeed, a comprehensive study by the IMF found no relationship between aid and growth. Moreover, economic growth in poor countries does not depend on official transfers from outside sources. Were that not so, no country on earth could ever have escaped from initial poverty. The long-held premise of foreign assistance—that poor countries were poor because they lacked capital—not only ignored thousands of years of economic development history, it also was contradicted by contemporary events in the developing world, which saw the accumulation of massive debt, not development.

Promotion of Market Reforms

Even aid intended to advance market liberalization can produce undesirable results. Such aid takes the pressure off recipient governments and

allows them to postpone, rather than promote, necessary but politically difficult reforms. Ernest Preeg, former chief economist at USAID, for instance, saw that problem in the Philippines after the collapse of the Marcos dictatorship: "As large amounts of aid flowed to the Aquino government from the United States and other donors, the urgency for reform dissipated. Economic aid became a cushion for postponing difficult internal decisions on reform. A central policy focus of the Aquino government became that of obtaining more and more aid rather than prompt implementation of the reform program."

Far more effective at promoting market reforms is the suspension or elimination of aid. Although USAID lists South Korea and Taiwan as success stories of U.S. economic assistance, those countries began to take off economically only after massive U.S. aid was cut off. As even the World Bank has conceded, "Reform is more likely to be preceded by a decline in aid than an increase in aid."

Still, much aid is delivered on the condition that recipient countries implement market-oriented economic policies. Such conditionality is the basis for the World Bank's structural adjustment lending, which it began in the early 1980s after it realized that pouring money into unsound economies would not lead to self-sustaining growth. But aid conditioned on reform has been ineffective at inducing reform. One 1997 World Bank study noted that there "is no systematic effect of aid on policy." A 2002 World Bank study admitted that "too often, governments receiving aid were not truly committed to reforms" and that "the Bank has often been overly optimistic about the prospects for reform, thereby contributing to misallocation of aid." Oxford's Paul Collier explains: "Some governments have chosen to reform, others to regress, but these choices appear to have been largely independent of the aid relationship. The microevidence of this result has been accumulating for some years. It has been suppressed by an unholy alliance of the donors and their critics. Obviously, the donors did not wish to admit that their conditionality was a charade."

Lending agencies have an institutional bias toward continued lending even if market reforms are not adequately introduced. Yale University economist Gustav Ranis explains that within some lending agencies, "ultimately the need to lend will overcome the need to ensure that those [loan] conditions are indeed met." In the worst cases, of course, lending agencies do suspend loans in an effort to encourage reforms. When those reforms begin or are promised, however, the agencies predictably respond by resuming the loans—a process Ranis has referred to as a "time-consuming and expensive ritual dance."

In sum, aiding reforming nations, however superficially appealing, does not produce rapid and widespread liberalization. Just as Congress should reject funding for regimes that are uninterested in reform, it should reject schemes that call for funding countries on the basis of their records of reform. This includes the Millennium Challenge Corporation, a U.S. aid agency created in 2004 to direct funds to poor countries with sound policy environments. The most obvious problem with that program is that it is based on a conceptual flaw: countries that are implementing the right policies for growth, and therefore do not need foreign aid, will be receiving aid. In practice, the effectiveness of such selective aid has been questioned by a recent IMF review that found "no evidence that aid works better in better policy or geographical environments, or that certain forms of aid work better than others."

The practical problems are indeed formidable. The Millennium Challenge Corporation and other programs of its kind require government officials and aid agencies—all of which have a poor record in determining when and where to disburse foreign aid—to make complex judgment calls on which countries deserve the aid and when. Moreover, it is difficult to believe that bureaucratic self-interest, micromanagement by Congress, and other political or geostrategic considerations will not continue to play a role in the disbursement of this kind of foreign aid. It is important to remember that the creation of the Millennium Challenge Corporation was not an attempt to reform U.S. foreign aid. Rather, the aid funds it administers are in addition to the much larger traditional aid programs that will continue to be run by USAID—in many cases in the very same countries.

Help for the Private Sector

Enterprise funds are another initiative intended to help market economies. Under this approach, the U.S. government, typically through USAID, has established and financed venture funds throughout the developing world. The purpose is to promote economic progress and "jump start" the market by investing in the private sector. Some of them have expired, some still exist, and others are being proposed.

It was never clear exactly how such government-supported funds find profitable private ventures in which the private sector is unwilling to invest. Numerous evaluations have found that most enterprise funds have lost money, and many have simply displaced private investment that otherwise would have occurred. Moreover, there is no evidence that the

funds have generated additional private investment, had a positive effect on development, or helped create a better investment environment in poor countries.

Similar efforts to underwrite private entrepreneurs are evident at the World Bank (through its program to guarantee private-sector investment) and at U.S. agencies such as the Export-Import Bank, Overseas Private Investment Corporation, and the Trade and Development Agency, which provide comparable services. U.S. officials justify the programs on the grounds that they help promote development and benefit the U.S. economy. Yet providing loan guarantees and subsidized insurance to the private sector relieves the governments of underdeveloped countries of the need to create an investment environment that would attract foreign capital on its own. To attract much-needed investment, countries should establish secure property rights and sound economic policies, rather than rely on Washington-backed schemes that allow avoidance of those reforms.

Moreover, while some corporations clearly benefit from the array of foreign assistance schemes, the U.S. economy and American taxpayers do not. Subsidized loans and insurance programs amount to corporate welfare. Macroeconomic policies and conditions, not corporate welfare programs, affect factors such as the unemployment rate and the size of the trade deficit. Programs that benefit specific interest groups manage only to rearrange resources within the U.S. economy and do so in a very wasteful manner. Indeed, the United States did not achieve and does not maintain its status as the world's largest exporter because of agencies like the Export-Import Bank, which finances less than 2 percent of U.S. exports.

Even USAID has claimed that the main beneficiary of its lending is the United States because close to 80 percent of its contracts and grants go to American firms. That argument is fallacious. “To argue that aid helps the domestic economy,” renowned economist Peter Bauer explained, “is like saying that a shop-keeper benefits from having his cash register burgled so long as the burglar spends part of the proceeds in his shop.”

Debt Relief

By the mid-1990s, dozens of countries suffered from inordinately high foreign debt levels. Thus, the World Bank and the IMF devised a $75 billion debt-relief initiative benefiting 39 heavily indebted poor countries. The initiative, of course, is an implicit recognition of the failure of past lending to produce self-sustaining growth, especially since an overwhelming percentage of eligible countries' public foreign debt is owed

to bilateral and multilateral lending agencies. Indeed, in 2006, at about the time the debt relief initiative began taking effect, 96 percent of those countries' long-term debt was public or publicly guaranteed.

Forgiving poor nations' debt is a sound idea, on the condition that no other aid is forthcoming. Unfortunately, the multilateral debt initiative promises to keep poor countries on a borrowing treadmill, since they will be eligible for future multilateral loans based on conditionality. There is no reason, however, to believe that conditionality will work any better in the future than it has in the past. Again, as a World Bank study emphasized, "A conditioned loan is no guarantee that reforms will be carried out—or last once they are."

Nor is there reason to believe that debt relief will work better now than in the past. As former World Bank economist William Easterly has documented, donor nations have been forgiving poor countries' debts since the late 1970s, and the result has simply been more debt. From 1989 to 1997, 41 highly indebted countries saw some $33 billion of debt forgiveness, yet they still found themselves in an untenable position by the time the current round of debt forgiveness began. Indeed, they have been borrowing ever-larger amounts from aid agencies. Easterly notes, moreover, that private credit to the heavily indebted poor countries has been virtually replaced by foreign aid and that foreign aid itself has been lent on increasingly easier terms.

The debt relief initiative has in fact reduced debt, but only time will tell whether this latest round of forgiveness will be yet another failed attempt to resolve poor countries' debt. Unfortunately, there are already worrying signs. For example, debt owed to official and private creditors has been rising steadily again in African countries that made up the bulk of the heavily indebted poor countries initiative. The public debt of Sub-Saharan African countries is now 35 percent of gross domestic product, up from 27 percent just four years earlier.

Other Initiatives

The inadequacy of government-to-government aid programs has prompted an increased reliance on nongovernmental organizations (NGOs). NGOs, or private voluntary organizations (PVOs), are said to be more effective at delivering aid and accomplishing development objectives because they are less bureaucratic and more in touch with the on-the-ground realities of their clients.

Although channeling official aid monies through PVOs has been referred to as a "privatized" form of foreign assistance, it is often difficult to make a sharp distinction between government agencies and PVOs beyond the fact that the latter are subject to less oversight and are less accountable. Michael Maren, a former employee at Catholic Relief Services and USAID, notes that most PVOs receive most of their funds from government sources.

Given that relationship—PVO dependence on government hardly makes them private or voluntary—Maren and others have described how the charitable goals on which PVOs are founded have been undermined. The nonprofit organization Development GAP, for example, observed that USAID's "overfunding of a number of groups has taxed their management capabilities, changed their institutional style, and made them more bureaucratic and unresponsive to the expressed needs of the poor overseas." Maren adds, "When aid bureaucracies evaluate the work of NGOs, they have no incentive to criticize them." For their part, NGOs naturally have an incentive to keep official funds flowing. The lack of proper impact assessments plagues the entire foreign aid establishment, prompting former USAID head Andrew Natsios to acknowledge, "We don't get an objective analysis of what is really going on, whether the programs are working or not." In the final analysis, government provision of foreign assistance through PVOs instead of traditional channels does not produce dramatically different results.

Microenterprise lending, another increasingly popular program among advocates of aid, is designed to provide small amounts of credit to the world's poorest people. The poor use the loans to establish livestock, manufacturing, and trade enterprises, for example. Many microloan programs, such as the one run by the Grameen Bank in Bangladesh, appear to be highly successful. Grameen has disbursed almost $20 billion since the 1970s and achieved a repayment rate of about 97 percent according to its founder. Microenterprise lending institutions, moreover, are intended to be economically viable, to achieve financial self-sufficiency within three to seven years.

Given those qualities, it is unclear why microlending organizations would require subsidies. Indeed, microenterprise banks typically refer to themselves as profitable enterprises. For those and other reasons, Jonathan Morduch of New York University concluded in a 1999 study that "the greatest promise of microfinance is so far unmet, and the boldest claims do not withstand close scrutiny." He added that, according to some estimates, "if subsidies are pulled and costs cannot be reduced, as many

as 95 percent of current programs will eventually have to close shop." More recently, David Roodman of the Center for Global Development found little evidence for the grand claims of the microcredit movement, including that it can noticeably reduce poverty. He advocated reducing funding for microlending and increasing its effectiveness.

Furthermore, microenterprise programs alleviate the conditions of the poor, but they do not address the causes of the lack of credit faced by the poor. In developing countries, for example, about 90 percent of poor people's property is not recognized by the state. Without secure private property rights, most of the world's poor cannot use collateral to obtain a loan. The Institute for Liberty and Democracy, a Peruvian think tank, found that, when poor people's property in Peru was registered, new businesses were created, production increased, asset values rose by 200 percent, and credit became available. Of course, the scarcity of credit is also caused by a host of other policy measures, such as financial regulation that makes it prohibitively expensive to provide banking services for the poor.

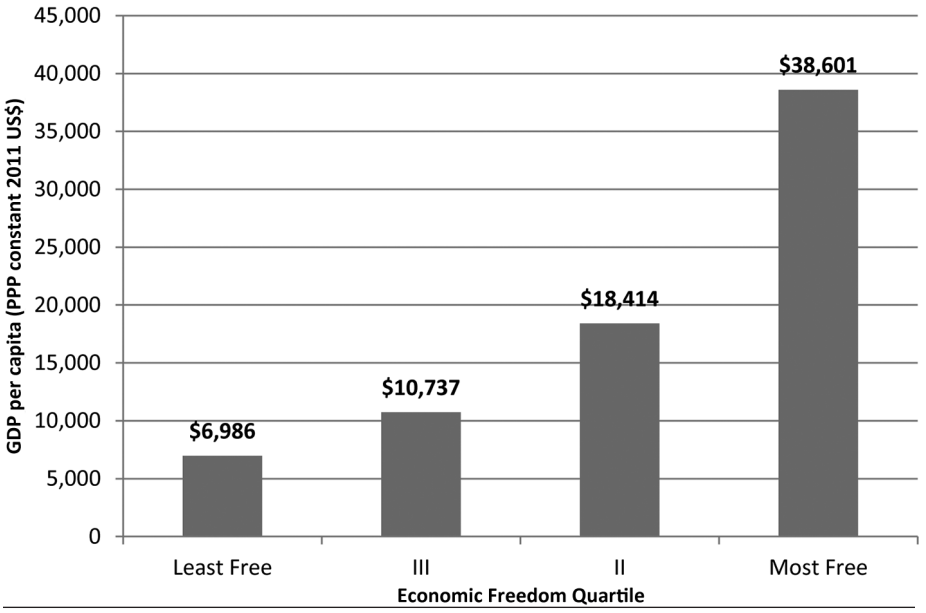
In sum, microenterprise programs can be beneficial, but successful programs need not receive aid subsidies. The success of microenterprise programs, moreover, will depend on specific conditions, which vary greatly from country to country. For that reason, microenterprise projects should be financed privately by people who have their own money at stake rather than by international aid bureaucracies that appear intent on replicating such projects throughout the developing world.

Conclusion

Numerous studies have found that economic growth is strongly related to the level of economic freedom. Put simply, the greater a country's economic freedom, the greater its level of prosperity over time (Figure 80.2). Likewise, the greater a country's economic freedom, the faster it will grow. Economic freedom—which includes not only policies, such as free trade and stable money, but also institutions, such as the rule of law and the security of private property rights—increases more than just income. It is also strongly related to improvements in other development indicators such as longevity, access to safe drinking water, lower corruption, and dramatically higher incomes for the poorest members of society (Figure 80.3).

The developing countries that have most liberalized their economies and achieved high levels of growth have done far more to reduce poverty

Figure 80.2
Economic Freedom and Income per Capita, 2013



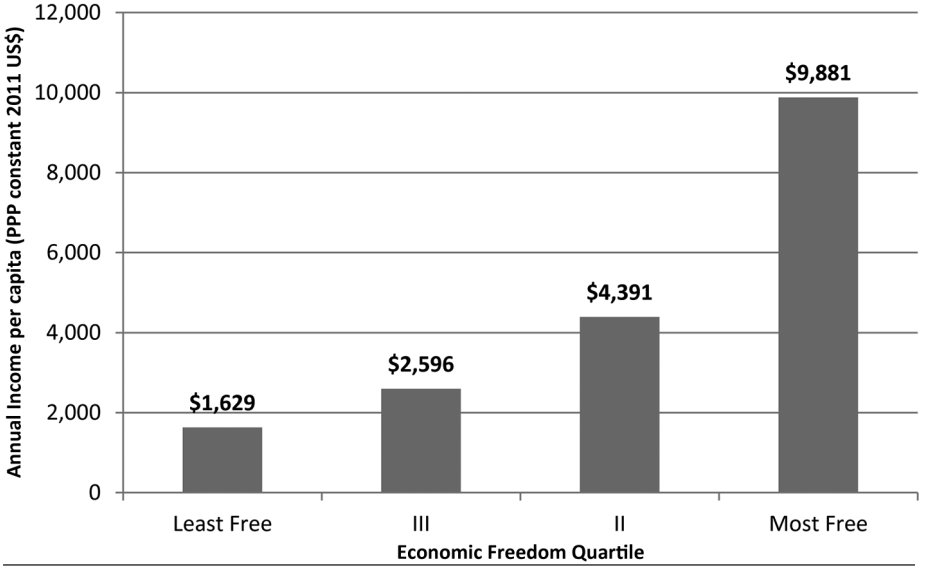
SOURCE: James Gwartney, Robert Lawson, and Joshua Hall, *Economic Freedom of the World: 2015 Annual Report* (Vancouver: Fraser Institute, 2015), p. 23.
NOTE: GDP = gross domestic product; PPP = purchasing power parity.

and improve their citizens' standards of living than have foreign aid programs. As Deaton observes:

> Even in good environments, aid compromises institutions, it contaminates local politics, and it undermines democracy. If poverty and underdevelopment are primarily consequences of poor institutions, then by weakening those institutions or stunting their development, large aid flows do exactly the opposite of what they are intended to do. It is hardly surprising then that, in spite of the direct effects of aid that are often positive, the record of aid shows no evidence of any overall beneficial effect.

In the end, a country's progress depends almost entirely on its domestic policies and institutions, not on outside factors such as foreign aid. As Easterly suggests, aid distracts from what really matters, "such as the role of political and economic freedom in achieving development." Congress should recognize that foreign aid has not caused the worldwide shift toward the market and that appeals for more foreign aid, even when intended to promote the market, will continue to do more harm than good.

Figure 80.3
Economic Freedom and Income Level of Poorest 10 Percent, 2013



SOURCE: Gwartney James, Robert Lawson, and Joshua Hall, *Economic Freedom of the World: 2015 Annual Report* (Vancouver: Fraser Institute, 2015), p. 23.
NOTE: PPP = purchasing power parity.

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Cato Institute

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